EXAMINATION OF CURRENT AGRICULTURAL CREDIT CONDITIONS; AND REVIEW OF LEGISLATIVE PROPOSALS TO ASSIST AGRICULTURAL PRODUCERS AND RURAL LENDERS

HEARING

BEFORE THE

SUBCOMMITTEE ON CONSERVATION, CREDIT,
AND RURAL DEVELOPMENT

OF THE

COMMITTEE ON AGRICULTURE
HOUSE OF REPRESENTATIVES

NINETY-NINTH CONGRESS

SECOND SESSION

ON

H.R. 3868 and Titles II and III of H.R. 4267

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EXAMINATION OF CURRENT AGRICULTURAL CREDIT CONDITIONS; AND REVIEW OF LEGISLATIVE PROPOSALS TO ASSIST AGRICUTURAL PRODUCERS AND RURAL LENDERS

WEDNESDAY, APRIL 9, 1986

House of Representatives,
Subcommittee on Conservation, Credit,
and Rural Development,
Committee on Agriculture,
Washington, DC.

The subcommittee met, pursuant to call, at 9:40 a.m., in room 1302, Longworth House Office Building, Hon. Ed Jones of Tennessee (chairman of the subcommittee) presiding.

Present: Representatives Glickman, Daschle, Stenholm, Tallon, Thomas, Stallings, Coleman, Morrison, Gunderson, Evans of Iowa, and Franklin.

Also present: Representative E (Kika) de la Garza, chairman of the committee; Representatives Bedell, English, and Panetta, members of the committee; and Representatives Dorgan and Lightfoot.

Staff present: Phillip L. Fraas, counsel; Charles R. Rawls, associate counsel; Cristobal P. Aldrete, special counsel; William E. O'Conner, Jr., assistant minority staff director, John E. Hogan, minority counsel; Mark Dungan, minority associate counsel; Glenda L. Temple, clerk; Robert A. Cashdollar, James W. Johnson, Jr., Bernard Brenner, Fred Clark, and Susan Adkins.

OPENING STATEMENT OF HON. ED JONES, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF TENNESSEE

Mr. Jones of Tennessee. Good morning. The Subcommittee on Conservation, Credit, and Rural Development will come to order.

We have a long day; there are many witnesses to be heard; subcommittee members have statements to make. The chairman of the full committee is here, and we will be hearing him as well as other members of the full committee.

The subcommittee is meeting today to gather further testimony regarding the continuing problems in our Nation's agricultural lending sector which have resulted from a deep and protracted depression in the farm economy.

Farmers and ranchers across the country are finding little to be optimistic about this spring as they enter another crop year which only promises further deterioration in prices and income. Agricultural lenders, both in the private and public sector, are reacting with predictable caution.

For the most part, farmers' cash-flow projections are worse this year than they were last year, and the level of loan denials and liquidations occurring these days are reflecting this sad fact.

I look for today's hearing to help document the extent of the credit problem in agriculture today. Federal regulators of commercial banks have recently announced plans to ease accounting and reserve requirements for troubled ag banks, and we will hear about this during the afternoon session.

In addition to gathering information about the extent of credit problems affecting producers and lenders, we will also look at two legislative proposals which have been introduced by our colleagues, Mr. Panetta and Mr. Bedell.

[H.R. 3868, the report from the Farm Credit Administration, and H.R. 4267 appear at the conclusion of the hearing.]

Mr. Jones of Tennessee. We have a good cross section of witnesses today, representing all major sectors of the agricultural lending industry, farm groups, commodity organizations, grassroots rural advocacy groups, and Government regulators. The agenda is heavy, so I would appreciate witnesses being as brief as they can during their oral presentations. We will also operate under the 5-minute limit during the questioning of witnesses.

At this point the chair will recognize other members of the subcommittee who wish to make a statement.

Mr. Coleman is recognized.

OPENING STATEMENT OF HON. E. THOMAS COLEMAN, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MISSOURI

Mr. Coleman. Thank you, Mr. Chairman.

I am indeed pleased to see this subcommittee conducting its second set of credit hearings this year. With spring planting upon us and many farmers still very uncertain as to whether or not they will receive operating credit to plant a crop, the focus of our attention can hold no higher priority than resolving the ongoing farm credit problem.

Those of us on the Agriculture Committee have been concerned about the declining condition of agricultural banks, even though we have limited jurisdiction over banking issues.

I am pleased the Federal Reserve, the FDIC, and the Department of Treasury have developed a program to help agricultural banks; and I am anxious to hear from bank regulators to better understand how these changes will help agricultural lenders.

I am deeply concerned, however, with the failure of the Farmers Home Administration's direct operating and guarantee programs in my State of Missouri. Although these programs have made impressive progress in the short period of time in other Midwest States, they have failed to take root in Missouri. Despite the availability of more that $52 million for guaranteed loans alone, the State of Missouri has only obligated 10 percent of these funds.

The moneys made available under the Farmers Home Administration program may be the last opportunity for many Missouri farmers to remain in agriculture. If these farmers are to stay in business they must have money in their hands within the next 3 weeks.

The time for debate over the merits of these programs is over. We need action immediately to get these programs working in Missouri and the money out to our farmers.

Later today, as you know, Mr. Chairman, in this afternoon's hearings, we will be hearing from officials with the Farmers Home Administration. At that time I plan to put forth several urgent proposals and requests regarding the implementation and supervision of these programs in my State.

Therefore, I will reserve the rest of my remarks until that time when the Farmers Home Administration representatives will be here to respond.

Mr. JONES of Tennessee. Thank you very much, Mr. Coleman.

Mr. Gunderson, do you have a statement?

Mr. GUNDERSON. Thank you, Mr. Chairman.

I am going to forego a formal statement so that, as you said, we can get on with the hearing and hear what they have to say. I think the purpose of the hearing is to try to get as much information of what is and what is not the credit problem in agriculture.

Let's get on with it.

Thank you.

Mr. JONES of Tennessee. Thank you very much.

Mr. Webb Franklin, you are recognized.

OPENING STATEMENT OF HON. WEBB FRANKLIN, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MISSISSIPPI

Mr. FRANKLIN. Thank you, Mr. Chairman. I concur with the remarks made by the ranking minority member of the subcommittee concerning the Farmers Home Administration. My district is drastically affected by Farmers Home Administration policy. There are still many farmers whose loans have been approved and who are waiting a decision on Washington to be funded. I look forward to the afternoon sessions with the Farmers Home Administration officials to delve into that question. I, too, will forego a further statement concerning the witnesses that will appear this morning.

And I am ready, willing, and able to try and assist the chairman and this committee in trying to come up with a reasonable response to what everyone realizes is a tremendous problem in the agricultural community.

Thank you, Mr. Chairman.

Mr. JONES of Tennessee. Thank you very much, Mr. Franklin, for your statement.

At this point I would like to recognize the Chairman of the full Agriculture Committee for any statement he might make, Mr. de la Garza.

OPENING STATEMENT OF HON. E (KIKA) de la GARZA, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF TEXAS

The CHAIRMAN. Thank you, Mr. Chairman.

I will leave it to the other members and the witnesses to discuss the actual situation with regard to agriculture for the credit sector of our agricultural problems. I do want to say, though, that this is a continuing problem, and we will continue looking at it. And I personally commend you and your subcommittee, Mr. Chairman, for continuing to stay abreast of the situation.

In spite of everything we have done, we are still hearing horror stories about Farmers Home, about farm credit, about the private sector, and we have to look at these problems. Your list of witnesses, it seems to me, constitute a very good group to discuss all the facets of credit for agriculture. I do hope that we can continue to look at the problem and see if any feasible and viable legislation is further needed.

I would like to sound a warning that we shouldn't go out and, for the sake of legislation or for the sake of whatever the interests of individuals are, send false signals or give false hope to individuals out in the countryside and the producers, and that we should be responsible to the extent that within the art of the possible we can effectively pass legislation which I think is needed. What we need to document is what type, and how, and how much, within the constraints we have on the budget.

But I would hope that these hearings and further hearings will not evolve into just posturing for other reasons besides trying to help those who need it in the agricultural sector. And I would hope that with this very impressive list of witnesses we would be able to document the situation as factually as we can and then that we might act accordingly.

I thank you, Mr. Chairman.

Mr. Jones of Tennessee. Thank you very much, Chairman de la Garza. We do appreciate your interest and the statement that you made there; and I concur in what you have to say.

Before we get to the panel of witnesses this morning, I am going to recognize at this point, Mr. Leon Panetta, who is a member of the full Agriculture Committee, and a member of the Budget Committee, here in the House, and very concerned about the problems that we face today.

And, Leon, you may sit where you are or you may go to the witnesses table, whichever you prefer.

OPENING STATEMENT OF HON. LEON E. PANETTA, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CALIFORNIA

Mr. Panetta. Thank you, Mr. Chairman. I am going to keep it as brief as I can. So, I will make my statement from here, if it pleases the chairman.

Mr. Chairman, one of the bills that is before the full committee for your consideration to try to deal with this issue is H.R. 3868. I have a number of cosponsors, including the chairman and yourself, as we try to put together an effort to try to deal with the issues that I think we are all concerned about, financial difficulties with many farm borrowers and their lenders, I think we all know are more severe today than since the Great Depression.

We are looking at more than one-third of our Nation's commercial size family farms that continue to experience very serious financial problems. And if we don't deal with that crisis now, then we will continue to try to resolve it through foreclosures and bankruptcies and bank failures.

If the agriculture economy sees a cascading rate of failures due to overburdened credit, the taxpayer and the Nation, I think, will ultimately be assessed in many ways. The new farm bill, as we know, was designed to try to make U.S. products more competitive on world markets by making sharp reductions in loan rates. The results have, to this point, been less than encouraging. Little improvement is expected in the export market. And this year agriculture revenue is projected to hit the lowest level in 8 years, over a 34 percent decline since their peak.

The problems facing you as farmers are compounded by the fact that world grain reserves are at record levels and a bumper crop harvest has kept commodity prices low. Not only are farmers in for another dismal year, but the farm banks are increasingly more vulnerable, as thousands of farmers will be unable to service their debt.

Scores of agricultural banks are already in grim shape, as we all know. The FDIC has reported that net-loan losses at agricultural banks nearly tripled over the past 2 years, and that 40 percent of the problem banks are farm banks; 62 farm banks, as we know, failed last year, the highest number of failures since the Great Depression. And this year another 60 farm banks are expected to fail.

Farm bank problems and failures will continue unless we do take immediate action. I was encouraged to learn of the recommendations, as I think all of us were, that the three bank regulatory agencies recently proposed in bank accounting rules to allow banks to deal with losses incurred by troubled farm and energy loans.

While this action is a step in the right direction, I am concerned that there is no mechanism to translate assistance down to the farm borrower. We in Congress, have the responsibility to deal with these problems now. That is why the substitute bill that I am offering in lieu of the original agricultural credit bill, H.R. 3868 is so important. This bill encourages lenders to use these liberalized accounting rules to restructure troubled farm debt by providing a matching interest subsidy program to lenders that reduce principal by at least 15 percent.

Borrowers, lenders, and the Government must share in the responsibility for fixing the present credit problems. Banks and other lenders can do much on their own to lighten the debt burden of their customers.

Lenders have indicated a willingness to do this; but many banks have been reluctant to write down loans or grant other concessions to borrowers because of the effect this might have on their capital levels.

Federal assistance is needed to provide the mechanisms and incentives to lenders to work with borrowers to effect long-term restructuring of the problem debt. This bill addresses the problem where the availability of new accounting rules does not necessarily insure that they will be used.

A case in point is the Financial Accounting Board's statement, what is now known as FASB-15. Although that program is now on the books, adequate notice simply has not been provided to the lender.

We must act to insure that lenders, examiners, and farm borrowers are fully aware of all of these restructuring options. This bill would require lenders to develop debt restructuring guidelines and give borrowers an opportunity to participate in such a plan before action can be taken on defaulted loans.

My goals are simple. We need a program that is a solution for our farmers, not simply a bailout for an institution or a bank. This bill is designed to give farmers and their lenders an opportunity to restructure their debts and to stay in business.

It is a reasonable and fair approach. And it doesn't bailout anyone. Instead it gives farmers and their lenders an opportunity to try to walk together out of a problem that they entered together.

We must act now to prevent huge loan defaults that shake the confidence in the Nation's financial system and obviously cause interest rates to rise and slow the growth of income and jobs. This bill, I think, would help restore the confidence on the main street of America, and among the farmers of rural America, if we can try to provide these incentives to help our farmers who are in trouble.

I think this is a responsible approach. I urge the members to take a very hard look at this, and see if we cannot in at the very least this year, move this kind of legislation.

I thank the chairman.

[The prepared statement of Mr. Panetta follows:]

REMARKS OF HONORABLE LEON E. PANETTA
4/9/86

AGRICULTURAL CREDIT ACT OF 1986

In the Nature of a Substitute to H.R. 3868

Today the financial difficulties of many farm borrowers and their lenders are more severe than any encountered since the Great Depression. More than one-third of our nation's commercial-sized family farms continue to experience serious financial problems. If we do not deal with the farm debt crisis now, we will continue resolving it through foreclosures, bankruptcies, and bank failures. If the agriculture economy sees a cascading rate of failures due to overburdened credit, the taxpayer and the nation will be assessed in many ways - not the least of which will be through FDIC guarantees.

Last year, the Administration vetoed legislation initiated by our Committee on immediate farm credit relief. The problems that our farmers have been struggling with for the last five years have not disappeared. The magnitude of the crisis has only grown worse and has had rippling affects on other sectors of our economy. Many communities are faced with a loss of population, declining property values, tax revenue, and public services. The outlook appears worse instead of better. Time is of the essence and inaction is clearly not the solution.

The new farm bill was designed to make U.S. farm products more competitive on world markets by making sharp reductions in loan rates. But, the results have been less than encouraging. Little improvement is expected in the export market. This year, agricultural revenues are projected to hit their lowest level in 8 years - over a 34% decline since their peak. The problems facing U.S. farmers are compounded by the fact that world grain reserves are at record levels and bumper crop harvests have kept commodity prices low.

To make matters worse, the value of the farmland that farmers use as collateral for their loans has continued to decline - compounding farmers' financial problems. Many farmers already burdened with high debt loads are being turned down for new operating loans by lenders worried about the prospects for recovery. Turned down by commercial lenders, many farmers have sought relief from the Farmers Home Administration, as the lender of last resort. But, the Agency has been unable to fulfill the flood of loan applications and reported in March that it ran out of money for new direct planting loans this year. As an interim measure, the Agency shifted limited funds into the direct loan program, but only through drawing down other FmHA loan accounts.

Not only are our farmers in for another dismal year, but farm banks are increasingly more vulnerable - as thousands of farmers will be unable to service their debt. Scores of agricultural banks are already in grim shape. The FDIC reported that net loan losses at agricultural banks nearly tripled over the past two years and that about 40% of the problem banks are farm banks. 62 farm banks failed last year - the highest number of failures since the Depression. This year, another 60 farm banks are expected to fail. Farm bank problems and failures will continue, unless immediate action is taken.

I was encouraged to learn of the recommendations that the three bank regulatory agencies recently proposed in bank accounting rules to allow banks to deal with losses incurred by troubled farm and energy loans. While this action is a step in the right direction, I am concerned that there is no mechanism to translate assistance down to the farm borrower.

We in Congress have a responsibility to deal with these problems now. That is why the substitute bill that I am offering in lieu of my original agricultural credit bill, H.R. 3868 is so important. This bill encourages lenders to use these liberalized accounting rules to restructure troubled farm debt by providing a matching interest subsidy program to lenders that reduce principal by at least 15%.

Borrowers, lenders, and the government must share the responsibility for fixing the present credit problems. Banks and other lenders can do much on their own to lighten the debt burden of their customers -- and lenders have indicated a willingness to do this. But, many banks have been reluctant to write down loans or grant other concessions to borrowers because of the effect this might have on their capital levels. Federal assistance is needed to provide the mechanisms and incentives to lenders to work with borrowers to effect long-term restructuring of problem debt.

This bill also addresses the problem where the "availability" of new accounting rules does not necessarily ensure that they will be utilized. A case in point involves the Financial Accounting Standards Board Statement (known as the FASB #15 program). Although the FASB #15 program is now on the books, adequate notice was not provided to lenders - as evidenced by the fact that the majority were unaware that such a mechanism exists. We must act to ensure that lenders, examiners, and farm borrowers are fully aware of all available restructuring options. This bill would require lenders to develop debt restructuring guidelines and give borrowers an opportunity to participate in such a plan before action could be taken on defaulted loans.

My goals are simple. We need a program that is a solution for our farmers -- not simply a bailout of an institution or a bank. This bill is designed to give farmers and their lenders an opportunity to restructure their debts and to stay in business. It is a reasonable and fair approach. It does not "bail out" anyone; instead it gives farmers and their lenders an opportunity to walk together out of a problem they entered into together. We must act now to prevent huge loan defaults that could shake confidence in the nation's financial system, causing interest rates to rise and slowing the growth of income and jobs. This bill would help to restore the confidence on the main streets and among the farmers of rural America.

(Attachments follow:)

LEON E. PANETTA
16TH DISTRICT, CALIFORNIA

COMMITTEES
BUDGET
CHAIRMAN
TASK FORCE
ON BUDGET PROCESS
AGRICULTURE
CHAIRMAN
SUBCOMMITTEE ON DOMESTIC
MARKETING, CONSUMER RELATIONS,
AND NUTRITION
HOUSE ADMINISTRATION
(ON LEAVE)

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April 4, 1986

Dear Agriculture Committee Member:

I have enclosed a substitute bill that I intend to offer in lieu of my original agricultural credit bill, H.R. 3868.

The three bank regulatory agencies recently proposed modifications in bank accounting rules to allow banks to deal with losses incurred by troubled farm and energy loans. While this action is a step in the right direction, I am concerned that there is no mechanism to translate assistance down to the farm borrower.

As you are indeed aware, the financial difficulties of many farm borrowers and their lenders are severe. Last year, the Administration vetoed legislation initiated by our Committee on immediate farm credit relief. The magnitude of the crisis has only grown worse and spread to other sectors of our economy. Time is of the essence.

The enclosed bill encourages lenders to use the liberalized accounting rules to restructure troubled farm debt by providing a matching interest subsidy program to lenders that reduce principal by at least 15%.

I am pleased that we will be able to examine these issues at the hearing on April 9th and believe that we must move forward with immediate legislation to deal with these problems. I look forward to working with you on this pressing matter.

If you are interested in co-sponsoring this bill, please contact Liz Turner on my staff at 5-2861.

Sincerely,

LEON E. PANETTA
Member of Congress

LEP/lt

Enclosure

4/4/86 AGRICULTURAL CREDIT ACT OF 1986

In the Nature of a Substitute to H.R. 3868

OFFERED BY LEON E. PANETTA

TITLE I: INTEREST SUBSIDY INCENTIVES FOR RESTRUCTURED LOANS

SECTION 101: GENERAL PROVISIONS

To encourage farm debt restructuring, this Act provides a matching interest subsidy program to lenders that reduce principal on troubled farm loans by at least 15%. As an added benefit, such debt restructuring would also allow lenders to participate in FmHA's Debt Adjustment Program (DAP). Under the DAP, loans that are restructured by at least 10% are eligible for a 90% FmHA guarantee.

From the date Act is enacted, borrowers have a one-year period in which they can apply to their lenders to participate in this three-year program. Loans that lenders have restructured during a six month period prior to enactment of this act would also be eligible for the interest subsidy.

SECTION 102: STATE AND FEDERAL INTEREST RATE PAYMENTS

Interest rate subsidies would be provided to qualified lenders through the Farmers Home Administration (FmHA). State participation is optional.

SECTION 103: PRINCIPAL AND INTEREST RATE REDUCTION

Up to 6 points of interest could be written down for those loans in which principal is reduced by at least 15%. The interest subsidy consists of 2% Federal, 2% State (participation is optional), and 2% Lender. For each additional 5% reduction in principal, one point of interest subsidy would be waived. The following table illustrates the incentive program:

Principal	Interest Subsidy Contribution			Total Interest
Reduction *	Federal	State **	Lender	Write-down
10%	Qualifies for 90% FmHA Guarantees under DAP			
15%	2%	2%	2%	6%
15% to 20%	2%	2%	1%	5%
20% to 25%	2%	2%	0%	4%

* In lieu of a principal reduction, lenders could reduce interest on fixed rate loans to acheive a comparable payment reduction over the life of the loan.

** State participation is optional. If State does not participate, Total interest write-down would be reduced by 2%.

SECTION 104: DURATION OF INTEREST RATE REDUCTIONS

At the end of this 3 year program, the interest rate charged on the restructured loan cannot exceed the standard rate charged by the lender for a comparable loan.

SECTION 105: RECAPTURE PROVISIONS

In the event of non-monetary default (violation of non-monetary terms of loan agreement without lenders' consent), the lender may enforce the terms of the loan as they existed before restructuring occured.

SECTION 106: LIMITATION ON FORECLOSURE

Requires lender to develop debt restructuring guidelines for farm borrowers and give them the opportunity to participate in debt restructuring program before taking action on a defaulted loan. This would not apply to loans under jurisdiction of bankruptcy court.

If a lender should foreclose on a participating borrower, the federal and state interest subsidy would be cancelled.

SECTION 107: USE OF CERTAIN FUNDS

Authorizes the Secretary to use the Agricultural Credit Insurance Fund to carry out this Act. Provides the Secretary with discretionary authority to use funds authorized in FY87, FY88, and FY89 under the interest subsidy program in the Farm Bill.

TITLE II: CONSERVATION PROVISIONS

Amends Section 1211 and 1212 of Food Security Act of 1985 to provide that any producer that cultivates highly erodible lands and wetlands will be ineligible for assistance under this Act.

TITLE III: ACCOUNTING PROVISIONS

SECTION 301: FEDERAL REGULATION OF THE ACCOUNTING FOR RESTRUCTURED AGRICULTURAL LOANS

Subsections (i) (1 - 5) Agricultural Loan Restructuring

Amends the Federal Deposit Insurance Act to provide lenders with more flexibility to restructure troubled agricultural debt - by minimizing effects of capital erosion and lending limitations. The following amendments are consistent with those proposed by the bank regulatory agencies in March:

A) FASB #15 - encourages banks to utilize a little-used accounting rule that allows banks to restructure loans without having to take a loss against capital if the restructuring results in payments that at least equal the original loan principal. FASB #15 (Financial Accounting Standards Board Statement No. 15) applies when "the creditor's objective is to make the best of a difficult situation...the creditor expects to obtain more...value from the debtor, or to increase the probability of receipt, by granting the concession than by not granting it."

B) Capital Forbearance - requires each Federal banking agency to establish a capital forbearance program for banks that have experienced a reduction in capital which is largely attributable to problems in the agriculture sector. Under such a program, a bank would be allowed to operate under relaxed capital requirements, provided they can demonstrate capacity to restore capital within five years. Currently, banks falling below the minimum 6% capital level are subject to stringent enforcement action by bank examiners.

C) "Call Report" Modifications - requires the Federal banking agencies to amend description of the status of restructured "troubled" loans in the Reports of Condition and Income (call reports). This requirement allows banks to distinguish loans that, although restructured (as under FASB #15), are in compliance with modified terms. Those loans would no longer need to be included in the category of nonperforming loans but could be disclosed in the call report as "Restructured and in Compliance With Modified Terms" or a similar description.

Subsection (j) (6) Limitation on Foreclosure

Requires lenders to develop debt restructuring guidelines for farm borrowers and give them the opportunity to participate in debt restructuring program before taking action on a defaulted loan. This would not apply to loans under jurisdiction of bankruptcy court.

Subsection (j) (7) Recapture Provisions

In the event of non-monetary default (violation of non-monetary terms of loan agreement without lenders' consent), the lender may enforce the terms of the loan as they existed before restructuring occured.

Subsection (j) (8) Definitions

With the exception that this Section only applies to banks that have their deposits insured by the FDIC, the definitions are basically the same as those listed under Section 404.

SECTION 302: MODIFICATION OF LENDING LIMITATIONS FOR LENDERS THAT RESTRUCTURE AGRICULTURAL LOANS

Amends regulations that establish lending limits for national banks so that a temporary reduction in capital would not reduce banks' lending authority. Currently, a decline in capital results in a parallel decline in the bank's maximum lending limit. By establishing an increased lending limit, a bank participating in the capital forbearance program who suffers moderate losses on agricultural loans could maintain its current dollar lending limits.

SECTION 303: REGULATION OF THE ACCOUNTING FOR RESTRUCTURED AGRICULTURAL LOANS BY STATE INSURED DEPOSITORY INSTITUTIONS

Requires appropriate State banking agency to amend State regulations to conform to amendments in Section 301.

SECTION 304: ADJUSTING REAL ESTATE HOLDING PERIODS FOR A NATIONAL BANKING ASSOCIATION

Increases the number of years that national banks can hold real estate, from 5 to 10 years. Currently, a bank must dispose of farmland it acquired through foreclosures within five years unless the Comptroller of the Currency approves the possession for an extended period not to exceed an additional five years. This provision is intended to relieve any further downward pressure on already depressed farmland values.

TITLE IV: MISCELLANEOUS PROVISIONS

SECTION 401 - Authorizes the Secretary to issue regulations to implement this Act within 30 days after the date of enactment.

SECTION 402 - This section clarifies that the requirement for fixed rate mortgages in any restructured loan supersedes any state law.

SECTION 403 - Provides for penalties under 18 U.S.C. 3623 or imprisonment for up to five years for those who steal, forge, misapply, etc., under this act.

SECTION 404 Definitions

"Agricultural Loan" - any loan made to finance production of agricultural products or livestock; or secured by agricultural property.

"Debt Restructuring" - loans restructured by any combination of: repayment period extension, interest rate reduction, principal reduction, or asset restructuring that would be accomplished over a ten year period.

"Qualified Agricultural Debt" - borrowers are limited to a $500,000 aggregate loan participation in the case of an individual and $600,000 in all other agricultural operations.

"Qualified Borrower"
- is any person that has made at least 50 percent of its gross income from farming in four of the past five years;
- has gross annual sales of at least $30,000 during three of the previous five years, and total net income not to exceed $100,000;
- is delinquent in the payment of principal or interest on agricultural loan;
- can demonstrate an ability to repay loan if debt is restructured.

"Qualified Lender" - any commercial bank, savings and loan association, credit union, insurance company, or farm credit institution.

"Qualified State Institution" - any State chartered depository institution that has deposits insured or guaranteed under State law.

PANETT236

[Discussion Draft]

[4 April 1986]

AMENDMENT IN THE NATURE OF A SUBSTITUTE TO H.R. 3868, AS INTRODUCED

OFFERED BY MR. PANETTA

Strike all after the enacting clause and insert the following:

SECTION 1. SHORT TITLE.

This Act may be cited as the ``Agricultural Credit Act of 1986''.

TITLE I--INTEREST SUBSIDY INCENTIVES FOR RESTRUCTURING LOANS

Sec. 101. IN GENERAL.

(a) REQUIREMENTS FOR RECEIVING PAYMENTS.--If a qualified lender agrees to reduce principal and interest rates under this title with respect to an agricultural loan to a qualified borrower, the Secretary, and appropriate State authorities (if so authorized under State law), shall make payments to that lender as described in section 102.

(b) LIMITATION ON LOAN AMOUNTS.--A reduction of principal and interest rates under this title may be made only with respect to loan amounts of a borrower totaling, in the aggregate, not more than--

(1) $500,000 in the case of a qualified borrower who is an individual; and

(2) $700,000 in the case of a qualified borrower who is a person other than an individual.

(c) PERIOD FOR INITIATING REDUCTIONS OF PRINCIPAL AND INTEREST.--

(1) Except as provided in paragraph (2), a reduction of principal and interest rates under this title may be made only within 90 days after the lender has received an application for such reduction submitted by the borrower within one year after the date of enactment of this Act.

(2) Paragraph (1) does not apply to a reduction of principal and interest rates made during the period beginning six months before the date of enactment of this Act and ending on the date of enactment.

SEC. 102. STATE AND FEDERAL INTEREST RATE PAYMENTS.

(a) PAYMENTS BY THE SECRETARY.--The Secretary, through the Farmers Home Administration, shall pay to a qualified lender making a reduction of principal and interest under section 103--

(1) an amount equal to two percentage points of the interest accruing on such loan throughout the period that an interest rate reduction remains in effect under section 104(a); and

(2) any amount received by the Secretary under subsection (b).

(b) PAYMENTS BY APPROPRIATE STATE AUTHORITIES.--With respect to a loan for which a reduction of principal or interest is made under section 103, the appropriate State authorities (if so authorized under State law), shall pay to the Secretary an amount equal to two percentage points of the interest accruing on such loan throughout the period that such reduction remains in effect under section 104(a).

SEC. 103. AMOUNTS OF PRINCIPAL AND INTEREST RATE REDUCTION.

(a) TABLE.--Except as provided in subsection (b), the reductions referred to in section 102 are as follows:

If the amount of principal on the loan is reduced by:	In States in which State payments are authorized under section 102(b), the interest rate on the loan shall be reduced, from the rate charged on the last loan payment due before the date of enactment of this Act, by:	In States in which State payments are not authorized under section 102(b), the interest rate on the loan shall be reduced, from the rate charged on the last loan payment due before the date of enactment of this Act, by:
At least 15 percent but less than 20 percent.	Six percentage points.	Four percentage points.
At least 20 percent but less than 25 percent.	Five percentage points.	Three percentage points.
25 percent or more	Four percentage points.	Two percentage points.

(b) EXCEPTION IN THE CASE OF FIXED RATE LOANS.--In lieu of a principal reduction described under the first column of the table in paragraph (1), a lender may reduce the interest on a fixed rate loan by an amount which will yield loan payments by the borrower comparable to loan payments which would be due under such principal reduction. An interest rate reduction under this paragraph shall be in addition to any interest rate reduction described in the second or third column of the table in paragraph (1).

SEC. 104. REDUCTION PERIOD.

(a) DURATION OF INTEREST RATE REDUCTIONS.--Except as provided in subsection (c), interest rate reductions made under section 103 shall be in effect for the duration of the loan or for a period of three years from the date of enactment of this Act, whichever is less.

(b) INTEREST RATES FOLLOWING REDUCTION PERIOD.--At the end of the period described in subsection (a) any interest rate charged on the balance of principal outstanding on a loan cannot exceed the standard rate charged by the lender for a comparable loan.

(c) EXCEPTION IN THE CASE OF INTEREST RATE REDUCTIONS MADE IN LIEU OF PRINCIPAL REDUCTIONS.--Interest rate reductions made under section 103 in lieu of principal reductions shall remain in effect for the duration of the loan.

SEC. 105. RECAPTURE IN THE EVENT OF NON-MONETARY DEFAULT.

In the event of non-monetary default by a qualified borrower on the terms of a loan whose terms are modified under this title, without consent by the lender, a qualified lender may enforce the terms of such loan as they existed before such modification.

SEC. 106. LIMITATION ON FORECLOSURE OF AGRICULTURAL LOANS.

(a) IN GENERAL.--Except as provided in subsection (b), a lender may not compel the forfeiture, by a borrower, of any security for an agricultural loan unless the lender first makes a good faith effort to reduce the principal or interest due on such loan in compliance with any applicable guidelines established under subsection (c).

(b) EXEMPTION FOR LOANS UNDER THE JURISDICTION OF A BANKRUPTCY COURT.--Subsection (a) does not apply to a loan of a borrower with respect to whom a case is pending in a bankruptcy court.

(c) DEVELOPMENT OF GUIDELINES.--Each lender receiving a payment under section 102 shall develop guidelines for determining which borrowers shall receive interest and principal reductions under this title.

(d) TERMINATION OF STATE AND FEDERAL PAYMENTS UPON FORECLOSURE.--No payment under section 102 shall be made with respect to a loan after a lender compels the forfeiture by a borrower of any security for such loan.

SEC. 107. USE OF CERTAIN FUNDS.

(a) USE OF AGRICULTURAL CREDIT INSURANCE FUND TO MAKE PAYMENTS.--The Secretary shall use the Agricultural Credit Insurance Fund established under section 309 of the Consolidated Farm and Rural Development Act to make payments under section 102(a)(1).

(b) DISCRETIONARY USE OF CERTAIN FUNDS.--The Secretary, at the Secretary's discretion, may use, to make payments under section 102(a)(1) during fiscal years 1987, 1988, and 1989 funds which would otherwise be available to the Secretary during such years under section 351 (e)(2) of the Consolidated Farm and Rural Development Act.

TITLE II--CONSERVATION PROVISIONS

SEC. 201. PROHIBITING ASSISTANCE TO BORROWERS WHO PRODUCE COMMODITIES ON ERODIBLE LAND.

Section 1211 of the Food Security Act of 1985 is amended--

(1) by striking ``or'' where it appears after the semicolon in paragraph (1)(E);

(2) by striking the period at the end of paragraph (2) and inserting ``; or''; and

(3) by adding at the end the following new paragraph:

``(3) treatment as a qualified borrower for purposes of title I of the Agriculture Credit Act of 1986.''.

SEC. 202. PROHIBITING ASSISTANCE TO BORROWERS WHO PRODUCE

COMMODITIES ON CONVERTED WETLANDS.

Section 1221 of the Food Security Act of 1985 is amended--

(1) by striking ``or'' where it appears after the semicolon in paragraph (1)(E);

(2) by striking the period at the end of paragraph (2) and inserting ``; or''; and

(3) by adding at the end the following new paragraph:

``(3) treatment as a qualified borrower for purposes of title I of the Agriculture Credit Act of 1986.''.

TITLE III--ACCOUNTING PROVISIONS

SEC. 301. FEDERAL REGULATION OF THE ACCOUNTING FOR RESTRUCTURED AGRICULTURAL LOANS.

Section 13 of the Federal Deposit Insurance Act (12 U.S.C. 1823) is amended by adding at the end the following new subsection:

``(j)(1) IN GENERAL.--The appropriate Federal banking agency shall--

``(A) permit an insured bank to account for qualified agricultural debt restructuring under paragraph (2);

``(B) establish a program of capital forbearance under paragraph (3) for an insured bank engaging in qualified agricultural debt restructuring; and

``(C) implement call report requirements under paragraph (4) with respect to qualified agricultural debt restructuring.

``(2) ACCOUNTING OF RESTRUCTURED LOANS.--Consistent with generally accepted accounting principals, an insured bank engaging in qualified agricultural debt restructuring involving only modification of terms may account for the effects of the restructuring prospectively and will not be required to change the recorded investment at the time of the restructuring unless the recorded investment exceeds the total future cash receipts that can be reasonably anticipated given the new terms of the loan.

``(3) CAPITAL FORBEARANCE PROGRAM.--

``(A) Under a capital forbearance program under this paragraph the appropriate Federal banking agency shall permit the capital of an insured bank qualifying under this paragraph to fall below any applicable minimum capital requirement established by such agency to the extent that the reduction in such capital is attributable to qualified agricultural debt restructuring.

``(B) In order for an insured bank to qualify under subparagraph (A) such bank shall, before December 31, 1987, submit to the appropriate Federal banking agency an application containing a plan acceptable to such agency which details the insured bank's program to restore primary capital to levels at or above the regulatory minimum not later than January 1, 1993.

``(C) The appropriate Federal banking agency may establish additional specific requirements consistent with the requirements of this Act which any insured bank must meet in order to qualify under subparagraph (A), including requirements that such an insured bank--

``(i) demonstrate that its weakened capital position is not due to mismanagement, excessive operating expenses, excessive dividends, or action taken solely for the purpose of qualifying for capital forbearance;

``(ii) adopt and adhere to its plan for restoring capital to the required minimums; and

``(iii) report periodically to the appropriate Federal banking agency on its progress in complying with the plan submitted under clause (ii).

``(4) CALL REPORTS.--Each Federal banking agency shall implement call report requirements for loans restructured under qualified agricultural debt restructuring, providing an accurate description of their status. Such loans may be disclosed as `Restructured and in Compliance With Modified Terms' or similar description.

``(5) IMPLEMENTATION DEADLINE.--Each Federal banking agency shall issue its program on capital forbearance and call report requirements for renegotiated loans not later than three days after the date of enactment of this subsection.

``(6) LIMITATION ON FORECLOSURE.--

``(A) Except as provided in subparagraph (B) an insured bank may not compel the forfeiture, by a qualified borrower, of any security for an agricultural loan unless the bank first makes a good faith effort to reduce the principal or interest due on such debt in compliance with any applicable guidelines established under subparagraph (C).

``(B) Subparagraph (A) does not apply to a loan of a borrower with respect to whom a case is pending in a bankruptcy court.

``(C) Each insured bank shall develop guidelines for determining which borrowers shall receive qualified agricultural debt restructuring.

``(7) RECAPTURE IN THE EVENT OF NON-MONETARY DEFAULT.--In the event of non-monetary default by a qualified borrower on the terms of a loan modified by qualified agricultural debt restructuring without, consent by the lender, an insured bank may enforce the terms of such loan as they existed before such restructuring occured.

``(8) DEFINITIONS.--For purposes of this subsection--

``(A) terms defined for purposes of the Agricultural Credit Act of 1986 shall apply to this subsection; and

``(B) the term `capital forbearance' means refraining from taking administrative actions to enforce capital standards.

SEC. 302. MODIFICATION OF LENDING LIMITATIONS FOR LENDERS THAT RESTRUCTURE AGRICULTURAL LOANS.

Section 5200(a) of the Revised Statutes (12 U.S.C. 84) is amended--

(1) by redesignating paragraph (2) as paragraph (3);

(2) by inserting after paragraph (1) the following:

``(2) If the Comptroller of the Currency establishes a capital forbearance program pursuant to section 13(j) of the Federal Deposit Insurance Act, the Comptroller of the Currency shall, without public notice and comment, amend the regulations under this section to establish new lending limits for insured banks covered by the forbearance program, individually or as a class, to compensate for the effects on such insured banks for losses attributable to qualified agricultural debt restructuring. A lending limitation established pursuant to this paragraph in lieu of the limitation established in paragraph (1) shall not exceed 20 percent of the unimpaired capital and unimpaired surplus of an association.''; and

(3) by striking, in the paragraph redesignated as paragraph (3) by this section, ``paragraph (1)'', and inserting ``paragraphs (1) and (2)''.

SEC. 303. REGULATION OF THE ACCOUNTING FOR RESTRUCTURED

AGRICULTURAL LOANS BY STATE INSURED DEPOSITORY INSTITUTIONS.

Notwithstanding any provision of the laws or constitution of any State, each appropriate State banking agency shall--

(1) permit qualified State institutions to account for qualified agricultural debt restructuring in the manner described in section 13(j)(2) of the Federal Deposit Insurance Act;

(2) establish a program of capital forbearance in the manner described in section 13(j)(3) of such Act for qualified State institutions engaging in qualified agricultural debt restructuring; and

(3) implement call report requirements of the kind described in section 13(j)(3) of such Act with respect to qualified agricultural debt restructuring by qualified State Institutions.

SEC. 304. ADJUSTING REAL ESTATE HOLDING PERIODS FOR A NATIONAL BANKING ASSOCIATION.

Section 5137 of the Revised Statutes (12 U.S.C. 29) is amended--

(1) by striking ``five years'' in the paragraph following the fourth designated paragraph and inserting ``ten years'';

(2) by striking the second paragraph following the fourth designated paragraph; and

(3) by striking ``five-year´´ in the last paragraph and inserting ``ten-year´´.

TITLE IV--MISCELLANEOUS

SEC. 401. REGULATIONS.

The Secretary shall prescribe regulations to implement this Act within 30 days after the date of enactment of this Act.

SEC. 402. LIMITATIONS ON STATE LAWS RESPECTING FIXED RATE LOANS.

Any provision of the laws or constitution of any State which prohibits fixed rate loans shall not apply to extensions of credit made under this Act.

SEC. 403. PENALTY FOR MISUSE OF FUNDS.

Whoever embezzles, misapplies, steals, or obtains by fraud, false statements, or forgery, any funds, assets or property provided or financed under this Act shall be fined under title 18, United States Code, or imprisoned for not more than five years, or both.

SEC. 404. DEFINITIONS.

As used in this Act--

(1) the term ``agricultural loan´´ means a loan made to finance the production of agricultural products or livestock in the United States or a loan secured by agricultural property;

(2) the term ``agricultural property´´ means land in

the United States that is in regular use for the production of agricultural commodities for sale and any personal property used on such land in the production of agricultural commodities;

(3) the term `qualified agricultural debt restructuring'--

(A) means any combination of--

(i) a reduction in the principal due on an agricultural loan to a qualified borrower for the duration of the loan;

(ii) a reduction in the interest due on such loan for the duration of the loan;

(iii) an extension of the term to maturity of such loan; or

(iv) an asset restructuring plan entered into between the borrower and lender, the terms of which shall, within ten years of the date on which such plan is made, accomplish the purposes of the Agricultural Credit Act of 1986 and the amendments made by such Act; but

(B) does not include any such combination which--

(i) reduces the term to maturity of a loan; or

(ii) is made with respect to loan amounts of a qualified borrower totaling, in the aggregate, more than--

(I) $500,000 in the case of a qualified borrower who is an individual; and

(II) $700,000 in the case of a qualified borrower who is a person other than an individual;

(4) the term ``qualified borrower'' means, with respect to an agricultural loan, a person who--

(A) has derived at least 50 percent of the person's gross income during at least four of the previous five years from the production of agricultural commodities, including livestock, poultry, and the products of aquaculture;

(B) has gross annual sales of agricultural commodities of at least $30,000 during three of the last five taxable years ending before the date of enactment of this Act;

(C) has as average net income of less than $100,000 during the last five taxable years before the date of enactment of this Act;

(D) is delinquent in the payment of principal or interest on such loan; and

(E) enters into a restructuring and asset liquidation plan acceptable to the lender which--

(i) demonstrates a reasonable likelihood that the borrower will be able to repay the amount of the loan if debt restructuring is made;

(ii) contains a schedule for the liquidation by the borrower of such assets as the lender may require as a condition for such restructuring; and

(iii) provides for annual review by the lender to ensure that the borrower is making a good faith effort to carry out the plan.

(5) The term ``qualified lender'' means a--

(A) commercial bank;

(B) savings and loan association;

(C) credit union;

(D) insurance company; or

(E) institution of the Farm Credit System.

(6) The term ``qualified State institution'' means a State chartered depository institution, the deposits of which are insured or guaranteed under the laws of a State.

(7) The term ``Secretary'' means the Secretary of Agriculture.

(8) The term ``State'' means each of the several States, the District of Columbia, the Commonwealth of Puerto Rico, the Virgin Islands, Guam, American Samoa, the Northern Mariana Islands, the Trust Territory of the Pacific Islands, and any other territory or possession of the United States.

Mr. **Jones** of Tennessee. Thank you very much, Mr. Panetta, for your statement; and we do appreciate your being here.

There might be other members who have arrived, who were not heard when the other subcommittee members were recognized.

I will now recognize Mr. Tallon for any statement.

Mr. **Tallon**. Mr. Chairman, I don't have a statement now.

Mr. **Jones** of Tennessee. Mr. Thomas, do you have a statement?

OPENING STATEMENT OF HON. ROBERT LINDSAY THOMAS, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF GEORGIA

Mr. **Thomas**. Thank you, Mr. Chairman.

Just briefly, I am glad that these hearings are being held and I appreciate the participation here today, because I have made this statement before. I still feel that the credit issue in agriculture is singly the largest problem that we are faced with today. Some of you probably caught the program that was done not too long ago by Dan Rather, when he showed that a farmer who went into farming in the past couple of years, and went out and bought land and equipment at these depressed prices, was able to cash-flow his operation, even with the low and depressed commodity prices today.

So, what I think we are really going to determine is whether or not we are going to say that by virtue of the fact that you have indebted on your farming operation, it is going to determine whether or not you stay in farming. We are going to have to help to work through that problem.

I simply don't think that it is wise to allow those farmers who have made investments, capital investments into their operations, and have bought equipment, and have bought land, simply to be forced out of business because the timing of their investment was not the wisest. Let's face it, a lot of people who are in the business of providing money have not been very wise with their decisions either.

So I think the whole issue in the end is whether or not we are going to come up with proposals that are going to help the farmer and not just the lending institutions. And I am all for these provisions that help our banks, our commercial banks, our Farm Credit System and others. But before I support these things to any further degree, I am going to be assured that I am seeing the kind of forbearance that I think is possible, and the kind of restructuring that is certainly feasible to prevent this thoughtless and unprofitable washout of farmers simply because there is no one being compelled to say we will restructure, and we will help these valuable farmers stay in business and work through their indebtedness problem.

So I simply want to set the tone of these hearings from my statement to begin with, I am going to begin to either see on behalf of all of those who provide farm credit some willingness to work and offer forbearance and restructure, and step away from this idea of this mindless washout and foreclosure process, or I don't intend to help anyone any further with any legislation designed simply to bailout the institution itself.

Thank you, Mr. Chairman.

Mr. **Jones** of Tennessee. Thank you very much, Mr. Thomas.

Mr. Bedell, you are recognized.

OPENING STATEMENT OF HON. BERKLEY BEDELL, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF IOWA

Mr. BEDELL. Thank you, Mr. Chairman.

One of the pieces of legislation that this subcommittee will be considering is the bill, H.R. 4267, introduced by myself, together with Mr. Daschle, Volkmer, English, and several others. I should say that I just returned from my district, and one thing that was pointed out to me at those district meetings is that somehow we are going to have to dig our way out from this farm debt, and unless we either get adequate income so farmers can get that debt paid off, or unless somebody eats it, we are going to stay in the same problem.

And by eating it, I am talking about the lenders would have to suffer that loss. Most of this legislation is an effort to address that problem, I believe.

Our bill is not necessarily perfect. We simply believe that there are some things in there which should be considered. One of the provisions in this bill is that you will only have to show a cash-flow of 100 percent.

There has been some argument that they have to show 110 percent. We think if we show a positive cash-flow, it should be adequate.

What it does is it enables the lender to write off a part of the loan and then get a Government loan guarantee. The argument being that if you can't handle a loan of $100,000 maybe they could one of $60,000, and they would be better off to have a good loan of $60,000, that lender would, than have to write off the whole $100,000, and be lost with that amount.

It also gives them a Government guarantee on part of that. It says that if the lender participates they cannot charge more than their own cost of money. And it gives them an opportunity to write off the part that they write off over a period of 10 years.

At least most of the people that I know feel that they have to have some time to handle those write offs.

I commend you very much for what you are doing with this subcommittee, for your looking at the problem. I think at the moment this is maybe the greatest problem we face. But I hope that we realize that bailing out the Farm Credit System, unless we do something to get that debt where we can manage it, is not going to solve the problem. It will postpone it but it will not solve it.

I thank you very much.

Mr. JONES of Tennessee. Thank you very much, Mr. Bedell.

Any other subcommittee members want to be heard at this point?

I see two have arrived.

Mr. Daschle, do you have any statement that you would like to make; we are hearing the subcommittee members?

Mr. DASCHEL. No.

Mr. JONES of Tennessee. Mr. Stallings, a member of the subcommittee, has arrived.

Do you have any statement you would like to make?

OPENING STATEMENT OF HON. RICHARD H. STALLINGS, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF IDAHO

Mr. Stallings. Mr. Chairman, I would like to commend you for calling this hearing today to examine the farm credit situation and discuss possible legislative and regulatory solutions this subcommittee may need to consider in the coming days.

I believe it is critically important for the subcommittee and the full committee to continue their leadership roles in this area of great concern to the vast majority of American farmers. Now is certainly not the time to turn our backs on the farmers and their lending institutions.

I hope you will agree that we must move forward quickly with appropriate fiscally responsible legislation that will offer long-term financial relief to our farm operators.

Mr. Chairman, I would like to go on record in support of the plan recently endorsed by the Federal Reserve, the Federal Deposit Insurance Corporation, and the Comptroller General that would help remove many existing barriers to the policy of forbearance on agricultural loans. But I am still greatly concerned with the very slow progress in finalizing many new Farmers Home Administration regulations.

Of greatest concern to Idaho farmers is in new provisions of the Food Security Act of 1985 that requires all applicants of emergency disaster loans to meet. FmHA has been working on a new definition of what constitutes a family farm for several months now, and we have yet to see any tangible ruling to share with our farmers.

This totally unnecessary delay in finalizing new regulations to govern the FmHA disaster loan program presents a serious problem for a majority of the farmers in my district who have suffered from a series of natural disasters last year, including drought, hail, grasshopper infestations, and a devastating potato frost.

The current definition of a family farm is very vague and subject to varying interpretations by FmHA county committees.

I am also extremely concerned with the lack of participation by commercial banks in the FmHA Loan Guarantee Program in Idaho. Thus far this year only 24 such guarantees have been made in Idaho.

I have talked to bankers about their reluctance to participate in this program and the general consensus seems to be a poor understanding of the program and burdensome paperwork requirements.

I hope that as this hearing progresses and we hear from these very qualified witnesses that many of my concerns will be answered.

Thank you, again, Mr. Chairman, for convening this hearing. I have a written statement I would like entered into the record, if there is no objection.

Mr. Jones of Tennessee. Without objection, Mr. Stallings, your statement will be placed in the record.

[The prepared statement of Mr. Stallings follows:]

STATEMENT BY REP. RICHARD STALLINGS FOR THE CONSERVATION, CREDIT, AND RURUAL DEVELOPMENT SUBCOMMITTEE HEARING ON THE FARM CREDIT SITUATION, APRIL 9, 1986

Mr. Chairman, I would like to commend you for calling this hearing today to examine the farm credit situation and discuss possible legislative and regulatory solutions this subcommittee may need to consider in the coming days. I believe it is critically important for this subcommittee and the full Committee to continue their leadership roles in this area of great concern to the vast majority of American farmers. Now is certainly not the time to turn our backs on our farmers and their lending institutions. I hope you will agree that we must move forward quickly with appropriate, fiscally responsible legislation that will offer long-term financial relief to our farm operators. I would also like to make a few general observations about the farm credit situation in this country and, in particular, my state of Idaho.

The farm economy continues to worsen in most parts of the country, including Idaho. A combination of falling land values that have reduced the collateral value of many loans, low commodity prices, and persistently high interest rates are seriously jeopardizing a large number of our small-to-moderate sized family farmers.

The roots of this agricultural depression can be found in the rapid expansion of the 1970s. During this decade, American agriculture experienced increasing export sales, stable commodity prices and rising asset values boosted by inflation. In addition, real interest rates were relatively low which meant credit was cheap. Urged to plant fence-row-to-fence-row to meet what was viewed as insatiable world demand, farmers became optimistic and borrowed money like never before. Generally, this type of behavior which resulted in a tripling of farm debt was in line with the inflation-psychology of the late 1970s and other indicators used to measure credit-worthiness. Unfortunately, there was an erroneous expectation shared by farmers, lenders and policymakers that this behavior would continue well into the future.

This situation was, in fact, completely reversed in the 1980s when new macroeconomic policies were used to wring inflation out of the national economy. Real interest rates were driven higher, thus strengthening the U.S. dollar abroad and increasing the cost of money at home. For agriculture, which is both capital intensive and export sensitive, this combination of events and government policy has proved devastating. Furthermore, it is increasingly clear that the favorable economic forces of the 1970s will not recur to provide significant relief to the farm sector.

For our farm economy to improve, our farmers need expanded export markets, higher commodity prices and lower real interest rates. I recognize that these needed adjustments will take time--time which most of our farmers won't have this spring without an adequate source of affordable credit.

Farmers, lenders and policymakers must forge a partnership now to ease the credit squeeze and halt the further demise of our rural economy. Several regulatory and legislative solutions need to be considered immediately and commercial lenders need to adopt a genuine policy of forbearance rather than foreclosure. We must consider legislation that should provide farmers and their lenders with the necessary flexibility to meet current demands. However, this is only part of the solution as we continue to pursue short-term policies that are designed to keep borrowers and lenders solvent from one year to the next in the hope that the farm debt/income situation would correct itself. At best, these current policies are short-sighted and, at worst, are based on false assumptions. It is clear that we need long-lasting financial relief and a return to profitability for all farm operators.

A plan recently endorsed by the Federal Reserve, the Federal Deposit Insurance Corporation and the Comptroller General would help remove many existing barriers to a policy of forbearance on agricultural loans. Specifically, banks would be allowed to operate below the 6 percent of total assets capital requirement if capital is replenished within five years. Banks would not be required to immediately write off loans that have been restructured and result in losses if restructured payments are equal to at least the loan principal. In addition, restructured loans would not automatically be categorized as "non-performing," but rather as "restructured and in compliance with modified terms." State banking regulators would have to agree to this reclassification.

I welcome these changes and hope that they will be wholeheartedly embraced by rural Idaho banks. The only possible drawback may be the length of time normally required to initiate changes in federal banking rules. The need to move quickly on these changes may require a legislative solution rather than waiting 30 to 45 days for administrative action to be completed.

Mr. Chairman, I am also gravely concerned with the very slow progress in finalizing many new Farmers Home Administration regulations. Of greatest concern to Idaho farmers is a new provision of the Food Security Act of 1985 that requires all applicants for emergency disaster loans to meet FmHA's definition of a family farm. The FmHA has been working on a new definition of what constitutes a family farm for several months now and we have yet to see any tangible ruling to share with our farmers. This totally unnecessary delay in finalizing new regulations to govern the FmHA disaster loan program presents a serious problem for a majority of the farmers in my district who suffered from a serious of natural disasters last year, including drought, hail, grasshopper infestations and a devastating potato frost. The current definition of a family farm is very vague and subject to varying interpretations by FmHA County Committees.

I am also extremely concerned with the lack of participation by commercial banks in the FmHA loan guarantee program in Idaho. Thus far this year, only 24 such guarantees have been made in Idaho. I have talked to bankers about their reluctance to participate in this program and the general consensus seems to be a poor understanding of the program and burdensome paperwork requirements.

Finally, I would like to express my concern with the delays in implementing the Farm Credit Act Amendments approved by this subcommittee last December. I strongly supported these amendments as a very necessary means to stabilize the Farm Credit System which holds nearly one-third of the nation's $214 billion farm debt. These amendments will enable the System to help troubled institutions by consolidating resources and selling nonperforming loans and acquired assets to the newly created Capital Corporation. They also reorganize and strengthen the Farm Credit Administration as an arms-length regulator and authorize the Secretary of Treasury to provide a direct line of credit to the System if the FCA certifies that such assistance is needed to keep to System solvent.

Unfortunately, the Administration has been extremely slow in making appointments to the newly constituted Farm Credit Board; consequently, necessary regulations to implement these changes are just now being finalized. However, the changes are not likely to result in lower interest rates to System borrowers in the short-term, and, therefore it may be necessary to consider direct financial assistance for System banks this year.

Mr. **JONES** of Tennessee. Anyone else on the subcommittee?

If not, I see that we have a vote on the floor of the House. I am going to call the first panel into place and ask that you be at the witness table when we return.

Mr. Neal Conover, chairman, First National Bank of Creston, IA. I understand that he is taking the place of Mr. Mike Fitch.

Mr. John Dean, chairman, Agriculture Committee, Independent Bankers Association of America, and president, Glenwood State Bank, Glenwood, IA; Mr. Douglas Sims, president and chief operating officer, Farm Credit Banks of St. Louis, and member of the Farm Credit Legislative Committee; and Mr. Les Horsager, vice president, Prudential Insurance Co., Newark, NJ, and he is hear on behalf of the American Council of Life Insurance of Washington, DC.

If you gentlemen will get in place while we are gone, we will go vote and return immediately.

[Recess taken.]

Mr. **JONES** of Tennessee. The subcommittee will resume its sitting.

We are pleased to have you appear this morning, and I regret the delay, but there is nothing this subcommittee could do about that.

Mr. Neal Conover, chairman, First National Bank, of Creston, IA, for Mr. Mike Fitch, I believe.

We are glad to have you, Mr. Conover, and you may proceed.

STATEMENT OF NEAL CONOVER, CHAIRMAN, FIRST NATIONAL BANK, CRESTON, IA, ON BEHALF OF THE AMERICAN BANKERS ASSOCIATION

Mr. **CONOVER**. Thank you Mr. Chairman, and members of the subcommittee. Mike Fitch the chairman of the ABA Agricultural Committee called from Denver at 10 o'clock last night. He took a late flight in order to stay and work on an interest buy-down program in the California legislature, and was backed up by air traffic control problems in Chicago. We called him at 7 o'clock our time, which is 4 o'clock California time, to work on remarks for today.

Bruce Meriwether also had to stay in Iowa. He is the president of the Iowa Bankers Association and was called back to his bank on some immediate measures. And I am hopeful that the rest of my bank staff is back at home working just as hard as Mike and Bruce. I am here to take their place; so I am glad to be here.

Perhaps in introduction. I am a member of the ABA Government Relations Committee, past chairman of the Iowa Bankers Association Agriculture Committee; current cochairman of the Iowa Bankers Association Legislative Committee.

My brother and I own two banks. One was purchased as a distressed bank in 1984. One bought as a failed bank from the FDIC. I own my own farm, and recognize the need for economic changes from many standpoints.

My remarks will reflect the written testimony that you have received, but in addition to that will include some remarks on my own bank experiences and some of what is actually happening in the community and with the customers that I am serving.

Our bank is like many others in the area. We have about 35 percent of our loans to farmers, the other 65 percent is indirectly to farmers, elevators, machinery dealers, employees of businesses that serve farming.

Banks are reported to hold 22 percent of total agricultural debt. In most banks this share in Iowa would be substantially larger than that. In fact, in our bank we have three times our capital level in loans directly to farmers, and that is an important point to remember.

One other important thing is that over the last 5 years farmers and bankers have been asked to make abrupt and severe changes in our attitude and our response to other changes that have occurred in the general economy. The farm program as an example is de-emphasized farm income, and has emphasized farm efficiency. Exports have been de-emphasized as a role in agriculture. The fiscal responsibility that the Government has bought through the general economy to agriculture, has required many changes.

The manifestation of these problems, or these changes, has resulted in a number of particular problems in our bank and in banking. One of those is that in Iowa it was reported this year that 50 percent of farm lines of credit will not cash flow. Asset values in Iowa are at one-third of their 1981 levels.

There are then those two problems that we try to identify particularly in our banks portfolio; one, insolvency of farm operations because asset values have declined below loan values. Even though the farm may be cashflowing, insolvency can exist.

Second, unprofitability because of high cost or low returns have resulted in many farmers being unable to service the debt that they have. These losses and responses to the general economy, if suffered into our banks balance sheet in too short a time frame, will severely impact our bank's capital. As you will recall, one third—excuse, three times our capital level is loan to farmers directly. If one-third of that debt is troubled our entire capital account could be wiped out if realized in too quick a period of time.

What do we need?

We need good management. We need time in order to stabilize the borrowers situation as well as our own banks' capital situation. Capital stabilization in the banking industry has resulted from the restructuring that is necessary in agricultural credits.

We are already restructuring debts, we have been doing so since the beginning of this agricultural reconstruction period. The way we do that in our bank and, I think, generally, in banks, is to identify the particular problem in the farm enterprise and then attempt to identify the particular solution to address that problem. It may be that if insolvency is the problem a combination of write downs and guarantees from Farmers Home Administration might address that.

If it is unprofitability that is the problem than interest buy downs or restructuring of enterprises on the farm, or cost-containment efforts can be used.

Now there have been introductions of some announcements from the OCC and FDIC, that would establish come capital forbearance and some leniency in capital. It will take some time to see if the regulators out in the field will interpret the needs of our banks and those new leniency rule effectively.

Our main response in the bank needs to be to the depositors of our bank and many of these are farmers who are now depositors in our bank who don't want us to be unduly subjecting our capital to too much stress. The borrowers situation must be particular to each individual farmer because each one is different.

I asked one young farmer in my office last week who has been profitable for the last 5 years, he told me, he said, I want to give you my farm back. I bought it 3 years ago; I paid $3,000 an acre for it; today it is worth $1,000. He has a negative net worth of $100,000.

He would like to give the farm back. He can now go out and buy three times as many acres today. He already knows he is profitable, and can manage profitably. He can buy three times as many acres today, so he doesn't want the restructuring in the conventional sense. He wants the banking system to restructure his debts for him.

And I think we need to be cognizant that some farmers want a different kind of restructuring than what we are conventionally and typically used to thinking about.

The Farmers Home Administration responsiveness has varied across the spectrum from left to right. We have seen some counties—we work with about seven counties with the banks that we operation. I was told by one county supervisor that he would not make guaranteed loans; he doesn't understand them; he doesn't like them.

We have also had a county where nearly every guaranteed loan in some way has been approved, perhaps not at the percentage that we requested it, but in some way was approved. So across that spectrum there is an inconsistency that industry has difficulty responding to, as well as farmers have difficulty responding to. And items of inconsistency like that need to be addressed.

We are also working with the Farmers Home Administration, Federal Land Bank, insurance companies, on restructuring long-term debts; with the extension service on restructuring farm businesses. That process of restructuring goes on every Friday at the local sale barn, when a farmer who has no money exchanges his property to someone who has money. That process continues.

Asset values are an important area, and I don't want to dwell any longer on that, perhaps, but to point that a secondary market is going to be necessary for the banking industry to continue the restructuring process over a longer period of time, that is to add diversification to a portfolio that has depended too long on operating capital to agriculture only. We need to be competitive.

Only one or two long-term lenders to agriculture is not satisfactory and in the best of farmers. Better service by introducing products that we can't originate ourselves need to be brought at hand.

Liquidity and outside funds need to be present because our depositing base can't always fund all the loan demands from each individual area. The ABA, the IBA, each individual bank, bankers' associations have worked diligently to stay after this problem of restructuring agriculture.

Time is necessary to allow our capital accounts to stand the pressure. And it is with those points that I will leave my testimony and respond to questions as you have them later.

Thank you, Mr. Chairman.

[The prepared statement of the American Bankers Association appears at the conclusion of the hearing.]

Mr. JONES of Tennessee. Thank you very much, Mr. Conover. We do appreciate your being here and appearing in place of Mr. Fitch, since he could not be here.

The questions will come later when we have heard from all the panel.

The next witness is Mr. John Dean, chairman of the agriculture committee of the Independent Bankers Association of America, and president of the Glenwood State Bank, Glenwood, IA.

STATEMENT OF JOHN C. DEAN, CHAIRMAN, AGRICULTURE-RURAL COMMITTEE, INDEPENDENT BANKERS ASSOCIATION OF AMERICA

Mr. DEAN. Thank you, Mr. Chairman.

As you said, I am chairman of the agriculture committee and president of the Glenwood State Bank in Glenwood, IA.

We appreciate your interest in the serious problems involving agricultural debt and the financing of the farmer. We are pleased to participate in these hearings.

There is some background I would like to give you on this information.

Based upon Federal Reserve data, commercial banks held $36 billion of production farm debt, and $11 billion of real estate farm debt. This represents over a 10 percent increase compared to 1984.

Net charge-offs of farm production debt by banks in 1985 totaled $1.3 billion, a 45 percent increase over 1984. On top of that a large percentage of banks in Iowa operated at a loss, and these are caused by loans to farmers.

Delinquent farm production loans at commercial banks at year end, totaled $3.7 billion, these are truly devastating figures. The farm economy is in shambles.

Banks generally have ample funds for lending to agriculture. And most of the banks farm customers now have their operating credit in place for 1986. However, there are cases where farmers are having difficulty qualifying for 1986 operating funds.

The options available to the lenders in working with these farmers have become limited. The severe constraints on Federal expenditures have rendered this means for relieving the financial pressures on the farmers less effective.

Because of the scarcity of options for dealing with problem loan cases, we have been working with the bank regulators and Congress to provide greater operational flexibility to banks. We have emphasized flexibility with respect to the bank capital levels in regard to problem loan workouts.

The two measures which are being implemented by the regulators, capital forbearance, and FASB-15, are similar in concept to the bills that are pending with this committee. I don't think I will go into these, I think we are all fairly familiar with the capital forbearance and the FASB-15.

Additional regulatory flexibility—this additional regulatory flexibility will benefit farm borrowers. It will help the farmers. It is not a bank legislation. It is a farmer oriented legislation.

These measures will give renewed confidence to agricultural bankers and will encourage the extending of credit to farm borrowers. Maintaining the banks prior lending limit will enable a bank to continue supplying the full credit needs of farm borrowers.

Just recently a bank was closed in Iowa, the main reason it was closed, or one of the reasons, was its lending limits go so low, it, in effect, couldn't operate. I think the lending limit got down some place near $40,000. And it just couldn't operate because of the capital restraints.

The FmHA Guaranteed Loan Program provides an important option for handling stressed farm loans. And that problem is being heavily used in agricultural States.

Direct farm home lending remains critical for many, many farmers. In our area, and I think Neal indicated the same thing, we have had good success with FmHA. I think our banks in Iowa are using the guaranteed loans, and using the direct loans.

We are very concerned if there is going to be enough money there to carry our people. And bear in mind on this, gentlemen, the problem in agriculture is the old debt, it is not this year's crop loan, it is the old debt that has to be some way accommodated, either by write-downs, or by stretching out, or by some sort of debt restructuring.

If we can get over that we have no problem. The interest rate buy-down program under the 1985 farm bill is a helpful option. We believe that program is authorized in the 1985 act, and will work out fine, if as such it can be expanded, and we hope it will be.

The other big problem in agriculture, another big one, is the secondary market. There is a big problem out there on long-term financing. It is almost nonexistent. The long-term people that used to come out and make the long-term, 20-year and 30-year loan on farms, are not. Everybody is afraid of farms right now.

They shouldn't be, farms are going to be here forever. They have been here for 100 years in our area, and they have taken care of us, and they are going to be ahead. We all tend, I think, to maybe have gotten overly optimistic in good times, and there is a great tendency to get overly pessimistic in the bad times.

And we need some sort of secondary market out there, either an Aggie Mae, or a combination of farm and the long-term lender. But there is a vast need out there for long-term secondary financing.

The ability of farmers to cash flow their debt load both old and new remains the bottom line consideration in the financing of production of agriculture this year.

I am confident that the agricultural banks will generally make the best possible use of these programs to get us through this production season. I see, as Neal did, in our area every loan that we have it is separate, it is a distinct thing. I don't know how many people have come in, and say, let's talk about the loan. And he says, are you going to be able to finance this year's crop? I say, yes, we can, but let's talk about the old loan, also. This year's crop financing is not a big problem.

Another factor that I would like to throw in that is not in my prepared statement is the stretch out of this deficiency payment is a tough thing. The deficiency payment comes, I think, 40 percent now and 30 percent in the fall, and 30 percent in 18 months. It is hard for a lender to look at that, anything past this first one. It is too long. If he is going to get it, he might as well get it.

I would be glad to answer any questions at the conclusion. Thank you, Mr. Chairman, for inviting us to participate.

[The prepared statement of Mr. Dean appears at the conclusion of the hearing.]

Mr. JONES of Tennessee. Thank you very much, Mr. Dean. And we will have some questions for you when have heard all the witnesses.

The next witness is Mr. Douglas Sims, president and chief operating officer, Farm Credit Banks of St. Louis, also member of the Farm Credit Council.

Doug, we appreciate your being here, please proceed.

STATEMENT OF DOUGLAS D. SIMS, MEMBER, LEGISLATIVE COMMITTEE, FARM CREDIT COUNCIL

Mr. SIMS. Thank you, Mr. Chairman, it is a pleasure to be here with you again today.

As you stated, I am a member of the legislative committee of the Farm Credit Council, representing the Farm Credit System here today. I will just cover the highlights of my prepared text in the essence of time.

First, I want to share with you and say to this subcommittee that we very much in the Farm Credit System appreciate the leadership that this committee took in moving the Farm Credit Act amendments through the House last fall. That has restored a great deal of confidence on everybody's part, clearly we have got the job ahead of us yet to do, but we appreciate the leadership that this committee gave to that effort.

One of the things I did last fall when I testified here before you is talk about the financial and credit problems that we were faced with. Clearly, I think the results of 1985 for the Farm Credit System show those predictions to have been very accurate. Our yearend report was published on February 14, and in that report the Farm Credit System reported an operating loss of $2.7 billion.

Last fall clearly Congress said that the Farm Credit System should utilize its earned surplus in dealing with these operating losses. In fact, we began to do that last year, 45 percent of our earned surplus was utilized in those operating losses, our earned surplus decreased from $6.2 billion to $3.4 billion.

Now those are just a couple of figures that I would share with you. Our annual report for the system is available, and we will be delivering those to your offices this week. We would encourage you to read those and ask any questions of us that you might have.

We are particularly proud and want to point out the unqualified opinion in that report by the auditing firm of Price Waterhouse & Co.; I think that ought to give both you, the banking system, and its stockholders comfort in terms of the numbers which was a major question of this committee last fall.

The legislation that you enacted last fall, really did two things for us. First, it maintained access to our markets for us. Second, it stabilized our cost of funds which were escalating rapidly.

Currently, our cost of funds are in the neighborhood of 30 to 35 base points over Treasury; you will recall last fall those reached as much as 125 base points over Treasury's.

Clearly, that legislation averted a funding crisis for the Farm Credit System. In spite of that major legislative effort, Mr. Chairman, we continue to operate in a very difficult environment that the two colleagues here have just talked about. Currently, the problem is not the availability of credit, it is the repayment ability of the borrower.

And clearly I was feeling many of the same things that Congressman Bedell was talking about when he was talking about the income problem that many of these farmers are faced with.

I am confident, as I sit here today, that the Farm Credit System is making every loan that has a reasonable chance of payment. And that is the key.

Clearly, our expectations were that there would be higher levels of operating loan rejections this spring; that was not the case. It was lower than we expected. We think that was largely the result of the new farm bill and some of the deficiency payments that have already been mentioned.

The emerging problem for us, clearly, is our interest rate situation in many areas. We are becoming noncompetitive as a result of carrying heavy levels on nonearning loans and acquired properties. Farm Credit System is not going to sit idly by, Mr. Chairman. We have made the decision, after this legislation that we need to move forward aggressively to utilize those tools that you gave us, and try to manage those problems to the best of our ability.

We are doing our best to implement the act that you gave us. We have notified borrowers of the forbearance policies, given them access to the loan documents as they asked for them, as well as the articles and bylaws. We are setting up those new loan review committees, that you have asked to set up.

We have begun the process of notifying borrowers who are in a nonaccrual status and have developed a philosophy statement to work with the Capital Corporation and the new FCA. The new Capital Corporation is now charted.

We are currently drafting a financial plan that would deal with mobilizing the system resources to be utilized by the most seriously stressed districts. The systems has elected its three directors to the Capital Corporation.

We have responded to the regulations of the Farm Credit Administration on those emergency regulations setting up the Capital Corporation. And at this point we are eagerly awaiting the FCA appointment of their two board members to that corporation.

It is our intent to move forward no later than May 1, even if those two members are not yet appointed by the FCA. We believe it is important to get on with this process and get that corporation upward and moving.

I think the attitude today, Mr. Chairman, in the Farm Credit System is that we have been given a new opportunity as a result of that legislation. We have tried to confront in the past weeks and months a number of the most difficult issues.

I would like to just highlight about four resolutions that we have come to in recent weeks.

The first one I talked to, that is to press for quick action and implementation on that 1985 act. We recognize it has taken time to get the new Secretary of Agriculture in place, and the new farm bill in place, but we need to get the board of FCA appointed and confirmed and those new regulations out.

Second, we are developing a business plan to return this Farm Credit System to long-term profitability. It is not our intent just to simply prepare to come back to here, to this committee, to ask for money. Our charge, as you gave it to us, was to build a business plan that would return the system to profitability, and we are about doing that.

The third thing that we are doing is that, clearly, we are going to have to change our philosophy on pricing. And we are building a new pricing philosophy that will take time to implement, to move away from the average cost pricing to incremental pricing, that is a major change for the system.

Clearly, it will mean locally competitive rates on a differential basis, based on risk and cost, which is different from what the system has done in the past. The key effort here is to be able to retain our best farmer and cooperative borrower.

Fourth, and certainly not least, clearly, the Farm Credit System is now going on record that loan restructuring is the preferred alternative for working with troubled borrowers. Clearly, foreclosure is the last alternative and the least preferred for any lender.

And contrary to what I know you hear, and what we read, the decision to foreclose on a farmer by a local farm credit association farmer board is the most difficult issue they deal with. Making the commitment to administer those troubled loans for farmers with the objective of maximizing the utilization of Farmers Home Administration programs is our objective.

We want to utilize those guarantees and those interest rate buydowns as a preferred alternative to foreclosure.

Now, let me say, Mr. Chairman, at this point, when you are talking about restructuring, you are talking about looking at loans on a case-by-case basis. And when you are talking about restructuring that includes forgiveness of interest or principal, you are talking about giving away money that is the capital of other borrowers of the Farm Credit System.

When we give $1 away, it makes one farmer very happy, and eight others very unhappy. And so we have to have some very strong principles around when that would be done.

We have tried to outline those three principles. First, that the borrower has dealt in good faith with its farming operation and with his lender.

Second, when that restructuring is done there is a realistic prospect of financial viability to the long run.

And third, and most important, that it will minimize any losses to the other borrowers of the Farm Credit System when that is done.

If those three things can be accomplished, then it is in our best interest, and the farmers best interest, for us to find a way to restructure those loans. Clearly, we intend to participate to the maximum extent possible in the Farmers Home Administration programs. We are currently having meetings with the State directors; we are having joint training programs; clearly, there are some paperwork issues to be dealt with. I think, we find the most critical factor is the cash flow issue.

Several legislative proposals are being talked about that would ask lenders to go further in forbearing, forgiving. We as lenders, have limited resources, and I know you are aware of that. We are stretching those as far as we can, as we try to deal with this problem.

But, clearly, more restructuring could be accomplished if, in fact, some of the programs that you are talking about were available with taxpayer dollars available for interest rate buy-downs. I assure you that if those come about we will do our best to make those a part of any restructuring or policy that the Farm Credit System would have.

Let me comment on one other concern that we have. When we had the legislation last fall, we clearly set up our regulatory agency as an arm's-length regulator. That was appropriate.

We have had a long history with our regulator; we are now in the process of getting used to that new relationship. But as that legislation was passed they retained many of the old responsibilities to manage our business, as well as new responsibility as an arm's-length regulator.

We believe it is very important that we be allowed to manage our business specifically in the area of setting our own interest rates. At present no interest rate in the Farm Credit System can be changed without the approval of our regulator the Farm Credit Administration.

In addition, they have put out a capital directive which calls for those kinds of actions and raises some questions about the ability of the system—utilization of some of the Farmers Home Administration programs as well as other interest buy-down programs.

We will continue to press, Mr. Chairman, for FCA's withdrawal from system management and into that arm's-length regulator role.

Let me summarize by saying that I believe that the Farm Credit System, after this legislation that you passed, has a strong commitment to move swiftly to implement that legislation. We heard your message very clear, operate as a business, but also deal with compassion in a humane way with those farmers who are struggling through this period.

We want to dedicate ourselves to looking at all of those alternatives consistent with those three principles in restructuring to help as many farmers as possible. Farmers and their lenders are faced with the most difficult situation we have faced since the depression. We recognize that.

Our objective is to try to get through this period and, yet, end up helping as many farmers as we can, but still maintain a sound dependable source of credit for those farmers.

Mr. Chairman, we appreciate the opportunity to share these views with you today and look forward to any questions.

[The prepared statement of Mr. Sims appears at the conclusion of the hearing.]

Mr. JONES of Tennessee. Thank you very much, Mr. Sims, for your statement, and there will be questions when we have completed our witness list.

The next and final witness on this panel is Mr. Les Horsager, vice president, Prudential Insurance Co., Newark, NJ.

STATEMENT OF LESLIE G. HORSAGER, VICE PRESIDENT, PRUDENTIAL INSURANCE CO., ON BEHALF OF THE AMERICAN COUNCIL OF LIFE INSURANCE

Mr. HORSAGER. Thank you, Mr. Chairman. I will make this brief since you have our written statement.

We appreciate the opportunity to express the views of the insurance industry which has been lending money actively to America's farmers for over 100 years. As a group we presently hold $12 billion in farm mortgages, which equates to 13 percent of all the farm real estate mortgage market.

As recently as the 1960's we shared the farm mortgage market about equally with the Farm Credit System. For years we worked hand in hand with the country banks in formulating complete financial packages for their customers.

These rural banks provided the operating loans, and we supplied the long-term real estate loans. This arrangement worked especially well until the 1970's.

At that time the Farm Credit System received expanded authorities which made it difficult for us to compete and our changing insurance products required our investments to be more liquid. Our need for greater liquidity in investments was caused by the rapid changes in insurance products being sold. These new products provide the policyholder, or pension manager, greater flexibility in selecting how their funds will be invested.

Consequently, our portfolio managers have become very reluctant to commit loans for long terms unless they have the ability to remarket these investments in the secondary market if their portfolios need to be repositioned. Just as the secondary market opened up the residential loans to a wide variety of homeowners, we are confident that broad private sector market for farm real estate loans can be accomplished by establishing an insured loan program in agriculture.

In today's environment such a program would lower the cost of real estate financing for farmers by approximately 2 percentage points. The concept would require the originating lender, probably an insurance company, a bank, or a partnership between an insurance company and a bank, to assume the top portion of the risk while being able to insure enough of the balance so as to permit the loan to be sold as an insured loan rather than a pure agricultural loan.

We think this program would necessitate setting up a Fannie Mae type corporation which would be, or should be, self-financing after its initial development, much like the residential programs are today. We are very concerned that private agricultural lenders, whether banks or insurance companies be granted approximately the same support as the Farm Credit System. Failure to do so will almost certainly lead toward further federalization of farm credit which we don't believe is in anyone's interest, especially the farmers.

We recognize the need for and we support the 1985 Farm Credit System legislation, but we suggest extreme care must be taken not to create two classes of farm borrowers and farm creditors.

In our opinion it is absolutely essential to diversify ag credit to as many sources as is possible. For example, approximately 50,000 farmers now have their real estate loans with insurance companies, and because of our broad diversification, we are able to employ a wide range of tools to resolve the problems in our portfolios.

At Prudential we take great pride in the fact that of 150 million dollars' worth of seriously delinquent agricultural loans resolved in 1985, only 15 percent involved an actual foreclosure. The rest were handled on a negotiated basis directly with the farmers.

I am of the opinion that were it not for some unavoidable Federal tax consequences to farmers, an even greater percentage of troubled loans could be settled outside of the judicial system.

Finally, we support the interest buy-down concept, provided it is open to all agricultural lenders, and is targeted to assist those farmers who have a chance of working out of their debt problems. Furthermore, we support those policies that help rural banks survive since we envision them as being key players in farm real estate loans that would be packaged for resale into the secondary market.

Accordingly, we believe Congress should establish equitable polices for all agricultural lenders, and find a way to enhance liquidity for agricultural mortgages through the development of a secondary farm mortgage market.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Horsager appears at the conclusion of the hearing.]

Mr. Jones of Tennessee. Thank you very much, Mr. Horsager, for your statement. We do appreciate, as I said, your presence here today.

Now the subcommittee will entertain questions to the panel. If there is no objection, the chairman is going to go first this morning.

I have only one question that I am going to ask the panel. I want to see what the opinion of this panel is as compared to some of the other panels that we have today, because I, as do all members of this subcommittee, realize how serious this credit crunch is, and it looks as if there is very little that can be done about it. So I want to present a proposal to you and see what you think.

I believe actually, regardless of what this hearing bears out, that it is pretty late this year for Congress to enact additional agricultural credit legislation and get it out there to the farmer in time to put the crop in, because crops are already being planted in some parts of the country and without credit others cannot be planted.

The Food Security Act of 1985, the bill that Congress passed and the President signed in December, gives the Secretary of Agriculture clear and extensive authority to make advance recourse loans through the Commodity Credit Corporation. A similar measure was vetoed by the President in early 1985.

As a member of this subcommittee, and as one who has watched credit for a long time, I believe this advance CCC Loan Program would go a long way toward addressing the farmers' problem immediately. Billions of dollars of operating credit could be made available simply by the stroke of a pen.

Now my question is to each of you at the witness table, do you believe the Secretary of Agriculture should exercise his authority and make these recourse CCC loans available to farmers at this time?

I would like to have frank, honest statements from any of you, if you feel that you are disposed to make this statement.

And then finally, if this loan program were implemented, how effective do you feel that it would be in calming the credit problems that we have out there?

And let's just take them in line.

Mr. Conover, you were first; so we will take you first.

Mr. **CONOVER**. Mr. Chairman, I would like to respectfully disagree with your position on that. No. 1, as stated earlier in testimony, the 1986 operating money is not the principal problem; lending money to put this year's crop in the ground is not the significant effort.

There will be cash flow provided by this year's farm bill eventually to pay that operating money if sufficient risk management techniques are applied on the farm, that is crop insurance, farm bill participation, crop bail insurance, a prudent financial plan is in place.

So whether that loan that our bank advances, or the Federal Government advances, we expect will be repaid from the eventual proceeds of the crop.

Instead our preference would be to leave the private sector in the place of providing credit, which is what we wish to do. We wish to provide credit to farmers in the long term.

What is the problem in farm credit today is the carryover debt. That has the burdensome effect of bogging down the individual year's profitability.

If implemented, I think what you might find is that farmers who don't necessarily have a profitable business plan; who ought not to survive, perhaps; or who ought not to farm; who ought to restructure their business in a different way, that is restructuring it, letting someone else farm the land, would be instead getting credit this year to farm unprofitably.

And instead at the end of the year we might find that farmer owing more money than he owes now, and in an even more difficult position to get out.

Thank you, Mr. Chairman.

Mr. **JONES** of Tennessee. Thank you, Mr. Conover.

The Chair regrets that he has to disagree with your position. And I don't admit on the front end that the long-term problem is all the problem.

The private sector today has the opportunity to pick up, and they have not. And we have a real serious problem in getting this crop in the ground this year.

Mr. Dean.

Mr. DEAN. I agree with Neal to a certain extent, that the long-term debt, the old debt is the problem. If we could get an advance on the loan from the Government this year there are—our association is not taking a position on this—but I think if we get an advance at this time it would be helpful in many cases.

Mr. JONES of Tennessee. Thank you, Mr. Dean.

Mr. Sims.

Mr. SIMS. Mr. Chairman, as you are aware, we supported this last year and continue to support this. I agree with both of my colleagues here, though, in all candor.

I just finished a meeting with over 2,000 farmers over the last 60 days, in meetings we have had, and the three States we served, and availability of operating credit was not an issue in any one of those meetings. As I shared, we were a little surprised about that.

I think some of the impacts of the farm bill are already being felt as a result of some of those advanced deficiency payments. Certainly, as those farmers get money, it will be helpful to them.

But the key problem that we are dealing with is past debts, not this spring's operating capital, in what we see.

Mr. JONES of Tennessee. Thank you, Mr. Sims.

Mr. Horsager.

Mr. HORSAGER. Really, I ought not to spend very much time on this because we are strictly a real estate lender. However, I would like to point out one thing that I feel very strongly about and that is the sooner all of agriculture gets on with recognizing the fact that there is a lot of debt that is probably not going to be repaid, the better off we are all going to be, and we get on with putting that behind us.

That really is not related to your question, but I do want to make that comment.

Mr. JONES of Tennessee. Thank you, Mr. Horsager.

My time has expired.

Mr. CONOVER. Excuse me, Mr. Chairman.

Mr. JONES of Tennessee. Mr. Conover.

Mr. CONOVER. May I add to the record the ABA position. We don't have an ABA position on that, you could probably tell from my remarks, that was a forthright and individual opinion.

Mr. JONES of Tennessee. Yes, sir, that was recognized in your statement.

Thank you very much, gentlemen.

The Chair yields to Mr. Coleman.

Mr. COLEMAN. The two commercial lenders, a very brief answer. If 100 percent is the problem in ag credit right now for you, how much has been solved by the regulatory changes that we all know about, that you mentioned today, 5, 10, 90 percent; give me a figure.

Mr. SIMS. Twenty.

Mr. COLEMAN. Mr. Conover.

Mr. CONOVER. The question isn't easily answered in percentages. There is only an atmosphere of constructive—there is a more constructive atmosphere now. Really, we need to see how regulators in the field are going to respond to what has been announced in Washington.

Mr. JONES of Tennessee. You are presuming that they are going to make this thing work?

Mr. CONOVER. If the capital forbearance that has been initiated by regulators actually comes into place in individual banks, a response could be 60 to 70 percent.

Mr. COLEMAN. All right. What about the timeliness of this?

How can you know about the actual implementation of these regulatory changes while you are making decisions today on applications for this year's credit; how do you handle that?

In other words, is it too late to affect this year?

Mr. CONOVER. Most of the banks have a responsiveness to restructuring the credits, but those all affect the capital accounts, and many of the banks that we are discussing here are under cease and desist orders. They need to have approval from regulatory bodies before they make extensions to credit for any of these troubled borrowers.

So an answer needs to come very quickly. Even though there was a 60-day time limit in some of the OCC and FDIC announcements, that may not be soon enough.

Mr. COLEMAN. Now, I have heard here this morning that current credit for this year's crop is not the problem. But at the same time these people are not going to plant this year's crop if the last year and the year before, and so forth, loan problems are still there. So, we do have a current problem, as well as an old problem. I think maybe it might be misconstrued.

Let me say to Mr. Sims, he was a constructive participant in the farm credit legislation that we passed, and I appreciate that very much. Having said that now, Mr. Sims, February 28, I asked your bank to start getting involved with the guaranteed program in Missouri; since Farmers Home people on the banks didn't seem to be working anything out, I wanted you all to get involved with it. I haven't gotten one bit of information that I asked for since then.

What have you done; what percent participation do you have in the guaranteed program; and why aren't you—it is not very high?

Mr. SIMS. Well, first of all, as you are aware, under the restructuring and the merger of the district, that we had to reapply for approval status; and we have applied. We have received approval from the State of Arkansas. We have yet from the States of Missouri or Illinois.

We have met with the State director. We have set up joint training programs, and have named a liaison in the office to work with that State director.

Clearly, the regulations, the new regulations have just come out. At this point there has been very little activity that I can report to you. I am unfamiliar with the specific questions that you ask. We will get those for you if you have not received them.

Mr. COLEMAN. Well, my general thrust was to try to make this program work as a lender, and ask for a weekly update as the

Farmers Home gives us weekly updates of participation levels, and I have not received it from Bill Hammitt, who I asked it of, or anybody else at your institution.

All of you, and we are talking about farmers here today, I want to know what the affect on Main Street business is when we see these farm communities, and these farmers going without their ability to function.

Mr. Dean, Mr. Conover, especially as commercial lenders, what is the effect on Main Street businesses, the small businesses that basically rely on an agricultural economy.

How are you handling that; and is this another part of the problem that we ought to address as we address the direct agricultural problem?

Mr. DEAN. You bet it is a problem. In just the last week I have talked to several Main Street merchants, and they said their business is down 20 to 25 percent. And you realize when that comes off the top it takes so much to crack the nut, and that is the profit.

And frankly, we see it as going down more. It is a real problem. I think it is really hitting the Main Street.

Mr. COLEMAN. And that hits your ability to loan to farmers again. It is vicious cycle downward.

Mr. DEAN. That is right. And loan to the merchant.

Mr. COLEMAN. Mr. Conover.

Mr. CONOVER. When losses occur in a farming operation somebody pays them. First the farmer loses all he can lose. Second, the unsecured creditors, which is often the elevators and the machinery dealers, and the farm suppliers. Third, is the secured creditors, very typically.

And what we see occurring is that when farmers have cut back their spending, they have cut back and have not been able to pay out, that is affecting the commercial business, the Main Street business, as well as bankers now being affected.

What we have then is the spiraling effect that is occurring. Now Main Street business are beginning to come forward with some backlash comments. Don't you understand that we are also affected. All the talk is about farmers and what we are going to do for them.

Mr. COLEMAN. Thank you.

Mr. JONES of Tennessee. Thank you very much, Mr. Coleman.

Mr. Daschle, you are recognized for 5 minutes.

Mr. DASCHLE. Thank you, Mr. Chairman.

I would join with the chairman in taking issue with the statement about the current credit of availability and the crisis that we have. I have to tell you in talking to my farmers just the last couple of weeks, that they view it as even a greater crisis than we had 1 year ago, that is the perception.

And it is perceived in three ways. First, the availability of funds through the Farm Credit Administration as well as through the Farmers Home. They, in many cases, have received loan approval 2 months ago and still have not received any loan availability at all. So loan availability is a real serious problem.

The second is the guaranteed program. You know that this year so far we have had only 175 loan guarantees provided. And that is a disaster.

Obviously, this was going to be the real anchor of the whole loan program, and it isn't working; for some reason it just isn't working.

And the third thing is still the cost of money. Even though they hear about all these loans and the rates plummeting, all other places, foreign countries, and New York, and all the financial community, their rates are still up in the double digits by a long ways, and I think, that is a grave, serious matter for a lot of these people.

I would like to ask, first of all, Mr. Sims. In this regard, you have mentioned, because you have not received approved lender status from the States, you have not participated in any kind of loan guaranteed program. Obviously, in some States you must have received this approved lender status, have you not?

Mr. SIMS. We just received it in Arkansas. And bear in mind, Congressman, that happened, we had approved status prior to the merger and consolidations. With that merger the approved status went away and had to be reapplied for, and we are currently waiting on that.

Mr. DASCHLE. Well, I tell you, we are going to be looking with great interest on the kind of involvement you can demonstrate with the approved lender program, or approved lender status; it really wasn't something that you participated in with great enthusiasm before.

Do you see that attitude is going to change now with the Commodity Credit Corporation?

Mr. SIMS. Yes, I do. I think one of the most difficult parts of those programs, though, Congressman, is the cash-flow requirements. In effect, under the requirements of the guaranteed program, these loans would meet the requirements that we historically have had and loans we would have made without the guarantee.

Bear in mind, that these loans need to cash-flow 100 percent, and that is the key problem that we are finding as we deal with these programs, not just the paperwork.

Mr. DASCHLE. When we were talking about the 175 in South Dakota, can anyone say with confidence that the guaranteed loan program, as it now is understood, is going to work much better than it did 1 year ago?

You answer is deafening. Just by your nonresponse the impression I have is that it isn't going to work; is that it?

Mr. SIMS. Well I will just comment for the Farm Credit System. The point that I was making with Congressman Coleman is that we are going to redouble our efforts to try to make that work better. I think from our standpoint we should have had more open lines of communications with the Farmers Home Administration. I don't think there is any question about that. We are trying to do that.

But certainly, the key factors here is many farmers do not have income strings or cash-flows that meet the requirements of the program.

Mr. DASCHLE. Well, you know, I think we have done a disservice to a lot of producers over the last couple of years. We have been telling them time and again, somehow we are going to make this thing work better. Somehow it is going to improve.

Somehow and some way you are going to get some credit relief, but we keep promising and there is just nothing there; 175 farmers out of 43,000 in South Dakota is not something for which we can take any satisfaction. And obviously, I don't see it getting better from what I hear this morning.

That is a grave concern as we are trying to resolve this thing. If we aren't going to do it through the guaranteed program; what is there?

Certainly, we can't look to Farmers Home. Certainly, we can't look to the reorganization in the immediate term. And so, I really question what is left.

With what time I have remaining, I could elaborate a little bit more on why you think the cost of money is still so high?

Is it because of the bad debt?

Maybe each of you could just address that very briefly.

Tell me how I can explain to my farmers——

Mr. DEAN. I think that the Farmers Home is working well in our area. It is working better than it did.

I think that one of the big problems is that we happen to have a very good man in ours, but he is overworked. He works 18 hours a day. They get him help. But if they don't get him trained help, that really doesn't help, he has got to do it all himself.

So in general, I think it does work better than it did, to answer your question. And we are utilizing the guarantee and the direct.

I think the interest rate thing is a real problem. Seventy percent of our customers want higher interest. There are the people who are selling the money to us.

Mr. DASCHLE. My time is up.

Mr. CONOVER. Do I have time to make two quick observations?

Interest rates remain high in our bank due to one thing, is the restructuring that we have already done. We have decreased interest rates and written principal balances to many customers. And as has been pointed out earlier, those costs to our institution need to be passed along some.

Also, a move down in interest rates in a banking environment lags behind the rest of the country, in both upswings and downswings. When prime rate in the country was 20 to 22 percent, we were 16 to 17 percent.

And now with prime rates down we are again lagging and, again, that cycle will follow, but it is not very satisfying right now.

Mr. SIMS. I think two things that I would say, Congressman, I don't want my comments misinterpreted on Farmers Home Administration to be for the total country. When I was responding to Congressman Coleman, I was talking about just the St. Louis district.

Nearly two-thirds of Farm Credit System associations are now approved lenders; and I want you to know that.

Second, I would comment that I think that the new regulations are going to make it better, at least as we have interpreted the new regulations that have come out some 20 days.

Relative to interest rates, I think our answer is the same, clearly the cost of dealing with the nonaccrual loans and the acquired properties of the Farm Credit System are being carried by all borrowers of the system, and very similar to the commercial banks.

Mr. JONES of Tennessee. The time of the gentleman has expired.

Mr. Gunderson you are recognized.

Mr. GUNDERSON. Thank you, Mr. Chairman.

I wanted to pursue the question that Mr. Daschle asked, myself. I would like you to expand a little bit further on this.

Are you suggesting to us that every loss that has occurred in your financial institutions in the past, you are going to make all of that up in the future; is that going to be made up only on agricultural loans; is it made up across the board on all commercial and personal loans?

There is a great deal of anxiety out there as to why the cost of money for ag loans remains as high as it does.

And I don't know what Tom's opinion is, but I don't think we have gotten adequate answers on that this morning. And if any of you can enlighten me further, I would sure like to hear.

Mr. HORSAGER. Since I didn't get a chance to respond before, let me go first on this one.

We have a limited amount of money available, obviously, as long as we are just using our own money. Now, the money that we are lending today on farm real estate loans is below 10 percent.

So I don't think our rates today that we are making farm real estate loans on are keeping with what we are getting on all real estate loans. So, from that standpoint, our bigger problem by far is our inability to move—package up groups of loans and move them through to any other market beyond just what we can use just within our own institution. And it is for that reason that we think that the secondary market is so important.

And you go over there—and we have been trying to sell farm loans in the secondary market without any kind of guarantees—and you go over there and they have been reading the Wall Street Journal and the New York Times, and all those kinds of things, and you just plain and simply scare anybody off from agricultural loans.

Mr. GUNDERSON. My time is limited, let me pursue a couple of other questions.

I don't think any of you have really told us what percent of last year's borrowers will not receive an operating loan for crop year 1986. I would like to hear, are you talking 3 percent, 5 percent, 10 percent of your borrowers, on the average of your institutions.

And second, there is a contention among a number of farm groups, the people who have paid off last year's operating loans still are being denied operating money in 1986; is that true in your institution, and if so; why?

I would like all of you to respond to those two questions.

Mr. CONOVER. We have, in the two banks that we have, we have made conditional commitments to everyone who farmed last year that they can get money to farm this year.

Mr. GUNDERSON. Whether or not they paid off their loan?

Mr. CONOVER. This is conditional commitments. Sometimes what the conditions have been, approval of other restructuring methods, other kinds of guarantees, collaterizations, other kinds of paydown on other debts. But you see the new operating moneys, they may not like the conditions, or they may wish to tell you we do not have financing arranged the way we want it. But they could get it if they are willing to take the——

Mr. GUNDERSON. What percent of these? No one is being denied?

Mr. Conover. No one is being denied; and there are only two conditional approvals.

Mr. Gunderson. Fine.

Mr. Sims.

Mr. Sims. We polled the Farm Credit System that number for the system is 7.8 percent this year. And obviously, in the more stressed areas that will move up toward 10. And in the less stressed, it will move down below zero, and it differs by areas and type of agriculture.

Mr. Gunderson. Did those who paid off last year's PCA loan, are they still being denied a loan this year?

Mr. Sims. I can't speak to that systemwide. I can tell you that our associations in the St. Louis district, and I believe we are consistent with the way the system operates, if a borrower can show a reasonable chance of repaying his loan, he is getting a loan.

Mr. Gunderson. Mr. Dean.

Mr. Dean. I would say that we have no borrowers that are not going to get financed this next year that we financed last year, that paid off or that didn't pay off.

Mr. Gunderson. Either way, whether they did or did not?

Mr. Dean. The point the chairman made, is if we could get some advanced money on this, this would make them cash flow better, which would help.

Mr. Gunderson. Well, the only one suggesting then that there is anyone who is not going to get loans this year is the Farm Credit System?

Can you Mr. Dean, and Mr. Conover, can you speak generally, I mean, obviously, not for every financial institution, generally, for your associations, that the commercial sector is for the most part responding that everyone who received a loan last year will get a production this year, whereas Mr. Sims is indicating is different in the Farm Credit System?

In my community there are reports, in fact, there are credit applications that we are receiving from people who don't have money arranged. They are PCA borrowers, or are they FDIC borrowers from a closed bank situation, or they are people who typically have been able to operate with some other kind of credit, dealer credit as an example, and don't have those credit lines arranged anymore.

So, we are seeing some of that. It is not a high percentage, I would say in the 5 percent range.

Mr. Dean. I would say the same thing. The bulk of the problem is closed banks where the FDIC has that credit and they are looking for credit.

When banks close it isn't the depositor that is in trouble, it is the borrower, because he is the one that is hung.

Mr. Gunderson. Thank you, Mr. Chairman.

Mr. Jones of Tennessee. Thank you very much, Mr. Gunderson. I think this is a very interesting kind of question, that we need to pursue it just a little bit farther, especially with ABA and the Independent Bankers Association.

Mr. Stenholm, you are recognized.

Mr. Stenholm. Mr. Conover, and Mr. Dean, and Mr. Horsager, all of you suggested we should consider establishing a secondary market for certain real estate, or long-term loans.

My question to each of you is should we also consider establishing a secondary market for farm operating loans, and if so, what advantages and disadvantages may accrue for your institution?

Mr. Sims, of course, you recognize we have done this with Capital Corp., for I believe, both operating and real estate within the farm credit system, so the question goes to the three of you to comment, please.

Mr. Conover. A secondary market for a farm operating loans, that role has typically been filled by correspondent bankers in the past. If a line of credit was too large for an individual bank to handle we could use a correspondent bank in one of the more metropolitan areas. At this point we also had availability to go through the discount window at the FICB in OFI type of environment.

Some of those kinds of avenues we expect will still be available, and perhaps enhanced by some cost-streaming of loans, as opposed to upstreaming now. I would say the need is not as dramatic there because the credit needs are shorter and more responsive to credit availability in other areas.

There are some bankers who are suggesting that a corporate paper kind of market might be available to fund operating needs, and in so doing we could pass along lower costs of money to farm borrowers. And I guess from that standpoint I would like to research that more and see what effect it might have on banks and on borrowers.

Mr. Dean. I would say in the secondary market that the big problem is that there isn't any long-term financing available now. Banks historically are demand money and they do not want long-term lending, or loans.

If you have got money in the bank and it is on demand deposit, and I loaned out for 20 years, you come in and want to take it out, and I say, gosh, I have got that loaned for 20 years, come back, you are going to be pretty upset.

Mr. Stenholm. That is current law.

My question was do you think that this is something that should be considered as far as helping to alleviate current and future problems?

I am aware of what the current situation is.

Mr. Dean. I don't think that there is a big problem on short-term money at this time. There is no long-term money available.

Mr. Horsager. I think that I would agree with that basically because the banks and the PCA's are still in place providing a nice balance of competitive balance. The long-term lending area, for all the reasons I talked about, we have really got down to a FCS, one source of long-term credit, and that needs to be broadened to get a private balance into it, I think. So, I guess, I would tend to agree with the banks.

Mr. Stenholm. If you have any additional thoughts on that I would appreciate you furnishing it to the committee for the record, along that line, if you do.

My second question, I want to go a little further on the guaranteed lending program, because it has already been brought out, obviously, it is not meeting the needs as, I think, as anybody had envisioned it and hoped it would to this time. It is helping to create some problems. And depending on the area and the individual banker, or the individual personality, it is working, or it is not working.

My question is what are some suggestions that you might make of how to make it more palatable, more acceptable, and more workable, if it is not being accepted, which it is not universally, nowhere near like we need it; what are still some of the things that need to occur, can you help us with that?

Mr. Conover, you are shaking your head.

Mr. CONOVER. One thing in particular, of a number of things, but one thing in particular, it is the process that has to be followed when a loan is ultimately closed out. If the restructuring is unsuccessful, and the farm needs to be liquidated and the guarantee put in place to cover any losses, the order of deficiency there is not like an SBA loan.

First the bank has to liquidate the farmer. A loss has to be determined. Once that loss is determined, a percentage of the loss is paid over to the bank. We recognize the difference between that and the SBA, where SBA steps in, buys out the guarantee at its percentage, and then SBA liquidates.

This makes the circumstance very difficult, you see, because if they argue the case that the bank did not follow due diligence in seeing that the collateral arrived on the scene, or if there is any other peculiarity in the way the communication might have been handled with Farmers Home, FmHA might instead of honoring an 80-percent guarantee, it might only honor a 60 or 50, some margin depletion of that. So bankers are concerned that they take a hit going into the guarantee, and might also take one going out. Beyond that there is a consistency in the delivery of one uniform product.

There ought to be one kind of guarantee, with set eligibility requirements, and not up to a lot of discretion by the county committees or county supervisors. But we see a spectrum of responses to identical kinds of loan applications. And that delivery system needs to be scrubbed up very, very much.

Mr. SIMS. A comment that I would make on that, Congressman, I think from our perspective you have got to look at the portfolio in segments and talk about where this program is designed to help. And when we look at our portfolio it divides very cleanly into three sections.

There is a third of the portfolio where the farmers are doing very well. And there is third where they are feeling the stress of both income and costs but are making the adjustments in getting through the period. There is the other third that we are all dealing with.

And if you take that third, and divide it in half, 15 percent, there isn't anything that those programs can do to help that 15 percent. Maybe it can help some of the other 15 percent in that lower third that is feeling the greater stress.

But the program largely is designed for the middle third. And that was a comment that I made awhile ago, I think, that as we look at the Farm Credit System, we have historically had a philosophy that we would not ask the Government to guarantee a loan that we would make ourselves. If it will cash flow, if it will repay, our directors have felt that it is important that that loan stand on its own, and we have had that philosophy.

I am not sure that program has targeted either the bottom 15 percent or the next 15 percent.

Mr. JONES of Tennessee. The time of the gentlemen has expired.

Mr. Cooper Evans, you are recognized.

Mr. EVANS of Iowa. Thank you, Mr. Chairman.

I would like to direct my first question to Mr. Sims. One thing, at one time on this committee a number of us thought it would be extremely valuable to the Farm Credit System to be able to write down losses over a period of several years, rather than taking the hit in 1 year.

That was strongly resisted at the Department of the Treasury at that time; it was totally unacceptable to them. Now they have accepted that principle as a matter of policy in regard to writing off of loans in commercial banks.

There would seem to be an imbalance there, and I would ask you do you think it is extremely important now that the farm credit system have similar ability to absorb losses over a period of years rather than instantaneously?

Mr. SIMS. Well, clearly, when you are dealing with a problem of the magnitude that all of us at this table are dealing with, time is an ally to get through this period, and I guess I would say that certainly that would be a help. But you would recall also, Congressman, that one of the major issues that was discussed in that legislation was the importance of the Farm Credit System moving to generally accepted accounting principles, which was done fully on December 31, 1985; and not only would the regulatory environment have to agree with that, so would the Accounting Standards Board, and that would be very critical to our investors continuing to want to invest in our securities, that our accountants would agree with those kinds regulations.

Mr. EVANS of Iowa. You would agree, however, that the commercial banks have the same problem, essentially?

Mr. SIMS. Yes.

Mr. EVANS of Iowa. You also understand that at the present time the Treasury is standing behind your system ultimately. And don't you think that would reassure the investment public if the writedown period was a very reasonable period of time, three increments over 3 years, maybe a maximum of 3, or 4, or 5, I think, 5 years is the maximum that has been suggested for the commercial banks?

Mr. SIMS. I think clearly after last fall the investment community is going to rely very heavily on the opinion of the outside auditing firm in terms of the value of the assets on our books. And I think that will be the thing they will rely on most heavily.

Mr. EVANS of Iowa. You think that will be the thing that they will rely on most heavily.

Do you think the FCA has the power to let you write things down now over several years?

Mr. SIMS. No.

Mr. EVANS of Iowa. Do you think that would take a legislative change, perhaps?

Mr. SIMS. I am not sure it would take a legislative change, Congressman. I think it would take a regulatory change. They may have the power to do it themselves.

Mr. EVANS of Iowa. Could you get me an answer as to what it would take?

Mr. SIMS. I will try to do that.

Mr. EVANS of Iowa. If I may to move the subject of the secondary market which has come up. I agree with all of you that is terribly important. I would like to tell you that just this morning I got back from Legislative Counsel a first draft of a bill that would provide that kind of service.

The bill that I have written will put that power with Farmers Home Administration as the guarantor and the buyer and seller; I am not sure that is the right place to put it. The reason for putting it there is that is an agency that is under the control of this committee, as opposed to if we created a new agency or put it somewhere we would lose control of the subject, and I am not sure we would ever get any action on it.

But I would just say to you that I have a draft of that available to any of you that would like to see it. And it clearly is only a point of departure, but I think it something we need to refine and get a number of inputs on. I would welcome your assistance and participation in that effort.

I would ask, Mr. Horsager on that point; you spoke to the need for a secondary market, and I would agree with you absolutely in the insurance industry. And I am a strong believer that we have got to get the insurance industry back into the business of long-term loans to agriculture. I am very, very supportive of that.

There are two ways you can participate, however. One of these is by actually making and retailing the loans. And the other way is by buying these mortgages on the secondary market once they have been guaranteed.

In your remarks you seem to be approaching it from the standpoint of the retailer, in talking to retailing of the loans and administering them. And in talking to many of the many life insurance people they say we pretty well disbanded that capability within our company. We don't have the retailing capability anymore.

My question to you is don't you think you would be on both sides of that market, perhaps, as an industry?

Mr. HORSAGER. Certainly we would be. As a matter of fact, there is really five very large agricultural lenders, ourselves are one of them.

There is another five that still staffs, in Prudential's case, for example, and the five, we have a professional staff scattered around the country that we would certainly utilize to be in the retail business. At the same time, though, we would expect that by setting up a secondary market, that outside of those 5 or 10 companies, everyone else would be strictly a buyer of those packages or mortgages.

Mr. EVANS of Iowa. On the secondary market; there would be some interest in that in the industry, would there not?

Mr. HORSAGER. Well, certainly; and we have tried to sell them without any kind of guarantee and not been successful.

Mr. EVANS of Iowa. Thank you, Mr. Chairman.

Mr. JONES of Tennessee. Thank you, Mr. Evans.

We have a vote on the floor of the House, and I know everybody wants to go vote. So, I am going to ask the witnesses to stay in place, if you will, and give Mr. Franklin and Mr. Thomas an opportunity to question you when we return.

There will be no recess for lunch, we will go right through the lunch hour.

[Recess taken.]

Mr. JONES of Tennessee. The subcommittee will resume its sitting.

Mr. Thomas, you are recognized for 5 minutes.

Mr. THOMAS. Thank you, Mr. Chairman.

Let me thank the members of the panel for appearing here today and for your excellent testimony. Some of it I have read over a little bit more in depth, and I assure I will do that as time permits.

I want to make a couple of statements first. I find it a little disturbing that there would be almost unanimous agreement on this panel here, that the idea of the advanced CCC loan going forward, is really not needed, and yet here we are talking about hearings on an area of legislation to help the various institutions involved in providing farm credit. And here is something designed to help the farmers, and yet we find our institutions going against it.

I hope you will look inward into your thoughts very deeply and think about this. Because, certainly if the farmer has a better chance to show a profit in his operation, he certainly is going to have an opportunity to meet his obligations.

Now, I want suggest that maybe you are a little greedy about your good borrowing clients, and you that want to keep them under your wings at your interest rates. But I will let you think on that yourself here.

The idea, though, gentlemen, that farm credit for this year's operating expenses is abundant and readily available, I think, has been somewhat erroneously portrayed by the members on this panel. And I hope you will go back and rethink your statements there.

The first thing that occurred to me was that we ran out of money in Farmers Home Administration, I went back immediately and got Vance Clark in, and he promised to get money to us in the course of about 8 to 10 days. We finally got some more money down there to handle a Farmers Home Administration loans that had been approved. And I found nowhere an abundance of operating money.

I find plenty of money in our agricultural banks, who, incidentally, I visited with last year, and are very interested in this legislation. But they are not willing to put money in at this time until they see some indication that we have touched bottom and that this precipitous decline in asset value of land are greatly forced and completed by continued foreclosures.

So what we need at this time is something that comes in and says that we are groping, we are touching, we are near the bottom, we are not going to erosion of land values because of this.

So, I did find some problem, although I respect very much the opinion of the members of this panel. I thought that Mr. Horsager's comment that somebody is going to have to eventually eat a great deal of this debt—and we are aware of that, Mr. Horsager—but at the same time we are involved in the process that hopefully in a constructive way will prevent that. And so I would rather think on the positive side.

With that statement being made, I introduced yesterday, and I think many of you know it, House Congressional Resolution 310, which is a concurrent resolution. It was introduced on the Senate side by Senator Nickles, designed to compel the Farm Credit Council, the Farm Credit Service itself, to look more closely at alternatives of forbearance rather than foreclosure.

I would like to pursue that since this is a particular interest of mine. It simply seems to me that what I see occurring in my district is that in the case of foreclosures that are promoted by the Federal Land Bank or Farm Credit Service in my district, that often times this farmer is, of course, foreclosed upon and then in the same vein the Federal Land Bank turns around and sells the land, when he can find the buyer, most often it is difficult, at a cheaper price, with no stock requirements, and at a lower interest rate.

Now, I want to ask what would be wrong if you took a loan and looked at it on this basis. You, in other words, were going to foreclose and the current market value was $400 an acre on land that you had $1,000 an acre when the loan was made, that you saw that by placing that farmer that you are going to foreclose on, and rather than just foreclosing on him, and writing him off, and bringing in a new buyer, if you said, OK, with what we could sell that land to the new purchaser for, we will work out a restructured debt, and keep that farmer in place, and we will weigh the cost clearly to the system, is it more costly to write off the farmer and make another loan, or is it easier to restructure this debt?

Now, that is what I was driving at in my particular resolution, and the reason I supported it. Because I want to reiterate this to you, in no way do I see this continued, and it is worse than a rash, it is an outright catastrophe, a catastrophic rate of foreclosures that is doing nothing for anyone.

I think there are workable alternatives. I want to know if you think that my suggestion of a restructured, possibly on a two-tiered basis, that if something like this can be worked out, given as well to the land bank, the provision that they could write off their loans over a longer period of time as well. I would like to hear your response to that please?

Mr. SIMS. First of all, I think that if it would fit within the principles, those three principles that I outlined in my testimony, then I think clearly that makes some sense because that ends up being the least cost method to approach. I think the key issue though, Congressman, is whether there is a chance of financial viability.

Now I will just give you an example. In the St. Louis district we have about 5,000 delinquent loans. Less than 1,000 of those loans are either in foreclosure or bankruptcy. We are working with those other 4,000 to find some solution to that problem, either through extensions, deferrals, restructuring, and clearly now what we are beginning to do is to take a look at what we could do in both interest and principal and see if that is the least cost method.

But what we are finding in many, many cases is that you are talking about the need to write down interest, anywhere from 6 to 8 percent, for the majority of these people in order to be able for them to cash flow, before you begin to make a dent in it. Many of those borrowers cannot cash flow at zero interest rate.

Mr. THOMAS. But when you, in effect, make a new loan on that farm that has been foreclosed upon, and require no stock purchase, and in many instances it is going to people who are not farmers, and I am watching this verbatim, and I can document what I am saying to you; what have you done there?

You haven't accomplished anything either, in my opinion.

Mr. SIMS. You are talking about our program to move the acquired property, that is a very costly and burdensome expense for the lender.

Mr. THOMAS. That is right.

Mr. SIMS. We have two options when we have that foreclosed property. One, is to continue to cut the price until it sells, we think that would be unconscionable on the part of the part of the Farm Credit System. It would do damage to the land market that was already fragile. And it would do damage to all good borrowers whether they were borrowers of the Farm Credit System or not. So in order to move that like any other piece of property that we have, we have put in place financing incentives under the sales contracts.

In our particular district, if you have got 20 percent down, you can have a sales contract at 8 percent. If it is only 10 percent down, it is 10 percent. And that is the incentive to get that land moved off of the market, off of our books, into the market, to take the pressure off the land bank interest rate.

Mr. THOMAS. I see my time has expired, Mr. Chairman. I certainly would like some additional questions later, if time permits.

Mr. JONES of Tennessee. The time of the gentlemen has expired. If he would desire to continue this discussion, he can do so after everybody else has been heard.

Mr. Webb Franklin, you are recognized.

Mr. FRANKLIN. Thank you, Mr. Chairman.

Mr. Thomas, I think I will continue on the same line, it is delicate question that is also happening in my farm credit area.

Mr. Sims, what is the policy of your Federal Land Bank, particularly in the St. Louis area, concerning the acquired property that you do have on hand, first?

And second, is there a difference in the policy of acquired property before the new act affecting the Farm Credit System, and acquired property after the act?

Mr. SIMS. I am not exactly sure what you are driving at, Mr. Congressman——

Mr. FRANKLIN. Do you have the same policy for land that you have in inventory, and that you have title to?

Mr. SIMS. Well, the current policy was really put in place, really, during the fall and winter, and was not impacted one way or the other by the act. The policies were put in place largely as a result of seeing the amount of acquired property that we would be accumulating through those foreclosures.

Mr. **Franklin**. Well, it is true, is it not, that you are taking acquired property and selling it at your current appraised value, at very favorable rates basically, compared to those rates that you have on the books for the farmers that were foreclosed.

Mr. **Sims**. Yes.

Mr. **Franklin**. Are you moving any of that property?

Mr. **Sims**. Yes, we are. Since the first of the year in our particular district, over $17 million of properties have been moved, 85 percent of that has been to farmers, and 65 to cash.

They are really not utilizing either the financing program very much and we are not finding investors coming in to look at that land. It is farmers who want to add a section onto their farm.

Mr. **Franklin**. What about acquired property that you are not able to move through these incentive sales techniques that you are trying use, are you leasing that land, or are you letting it go fallow this year? I am talking about the good rope of crop farmland that you have on hand.

Mr. **Sims**. In every case where we can do it, we are renting it back to the farmer that was on the land. When that isn't an option, we are leasing it to another farmer in the area. We are not leaving it lie.

Mr. **Franklin**. Do you have the judgment call on whether or not to release the land that has been foreclosed to the farmer, or are you restricted to some degree by the regulator now on that?

Mr. **Sims**. No, we are not restricted by the regulator, that really becomes a local board and local management decision.

Mr. **Franklin**. And in your district those decisions are being made more times than not in favor of the farmer who knows the land, who has been on it and has farmed it in the past?

Mr. **Sims**. And if he has the financing available to more forward.

Mr. **Franklin**. Are you on the other arm of the system, PCA or PCA's participating in the financing of those people for crop furnishes for this year?

Mr. **Sims**. When they can.

Mr. **Franklin**. Is the Capital Corp., as it is perceived to you, sir, a way that this acquired property can be transferred from your books to theirs, to help you with the interest rate problem that you described to us? Can you transfer, or do you foresee being able to transfer acquired properties to the Capital Corp. for resale or get off the books from that level rather than yours—is the Federal Land Bank going to continue to have to market its own acquired property; or is the Capital Corp. going to do that; or is there going to be a combination of both?

How is that going to work?

Mr. **Sims**. It would be a combination of both, Mr. Congressman. And remember the Capital Corp. is a system institution. It will help the most stressed districts; but overall the rest of the banks will be picking up the expenses of the Capital Corp. So it is not going to immediately have a major downward impact on interest rates other than as has already been seen in both Spokane and Omaha, there has been some reduction as a result of those. So it is a positive steps in the right direction, but it is not going to change things overnight.

Mr. Franklin. You indicated in earlier testimony that you are going to change your philosophy on pricing, and the new act was going to allow you to do that, in order to keep the good borrower rather than running him away, in other words being competitive, is that correct?

Mr. Sims. Yes, that is the objective.

Mr. Franklin. You described your borrowers in a class of one-third, one-third, and one-third. One-third that are pretty well off; one-third that are hanging on; and one-third that are in trouble.

If you have a pricing philosophy change instead of having the same interest rate for everybody, are you not exacerbating the problem by charging a higher interest rate to the lower category of borrowers that you have?

Mr. Sims. Well, I can speak to what St. Louis is doing. As opposed to raising the rates of those, we are dropping the rates for those who are the most credit worthy. Which is what is done in the credit business.

So, we are not exacerbating that problem by raising the rates. That has been suggested a time or two by our regulator, we think that is not the thing to do.

Mr. Franklin. In other words, if you charge 11 percent to the bottom one-third that are trouble, and 9 percent the top people who don't have the credit problem, are you not creating more problems for the bottom one-third?

Mr. Sims. Well, it is those that are in deepest trouble where the cost and the expenses are being borne by the majority of the stockholders. And they do not believe that they subsidize to their interest rate those where the bank is spending the most time and effort in expense and collection.

Mr. Franklin. If I could have 1 additional minute. Thank you, Mr. Chairman.

How much of the cream have you lost in your district, of the top end borrowers, by virtue of the high-interest rate that you need to change?

Mr. Sims. I would say somewhere in the neighborhood of 7 or 8 percent; some areas it is as high as 10, by not changing soon enough.

Mr. Franklin. Thank you, Mr. Chairman.

Mr. Jones of Tennessee. Thank you very much, Mr. Franklin.

Mr. Stallings, you are recognized for 5 minutes.

Mr. Stallings. Thank you, Mr. Chairman.

I am intrigued by the questions that Mr. Daschle and Mr. Gunderson asked on the guarantee program. We set aside a considerable amount of money for that guarantee program, and yet it is not working in Idaho, it is not working nationally, apparently.

Why, in your experiences in your end of the business, why are banks not using the guarantee program?

Mr. Dean. It is hard for me to say, because in Iowa, I think, it is being used, it is being used quite a little bit. The Farmers Home tried last year to make it more acceptable, and they made some adjustments which did make it more acceptable to the banks. I still perceive the biggest problem, the thing that Neal said, and that is it is not like an SBA, if it goes bad—or there really is a perception out there, because we haven't had enough of them decide, there is a perception out there that you really don't know where you are if it goes bad.

And as I understand the reason that was set up originally, that was because of a decision in North or South Dakota which the judge said that a FmHA cannot foreclose. And they were saying, look, if we can't foreclose, what can we ever do.

Now, if that could be set up more like an SBA, I think it would be used a lot more. But it is being used; it is a good program.

Now, it could be improved. But it is being used, and the direct loans are being used. And I want the Congress to facilitate that program, it has saved a lot, a lot of people, and will save more.

Mr. EVANS of Iowa. Would the gentleman yield just briefly on that point?

Mr. STALLINGS. Yes.

Mr. EVANS of Iowa. As a Representative from Iowa, where these two bankers come from, to confirm to you that in the State of Iowa the program is being very, very widely and effectively used, and that is not true in many of the other States of the Union. And I have a report done for me on that because the Government Accounting Office, which I would be very pleased to make available to you, if you wish to have it.

Mr. STALLINGS. Yes, I would.

Thank you very much.

Let me direct this one to Mr. Sims.

In your testimony you outline a plan to implement a new pricing philosophy to achieve more competitive interest rates. Given the nearly $2.7 billion losses suffered in 1985, and system reserves rapidly dwindling, exactly how will the system lower interest rates without outside financial assistance; and how long before the systems reserves will be exhausted?

Mr. SIMS. First of all, this new pricing philosophy isn't something that you can implement overnight. And historically the Farm Credit System for the most part, not in all cases, but for the most part, used an average cost pricing system.

Whatever the cost of money was on the average, if the operating expenses were added, and you will recall when prime rate was 22 and Federal Land Bank loans were 12 or 12¼, that meant that it lagged the market very, very significantly. Same thing on the way down.

What we are finding, though, is that the farmers are saying, don't tell me what you did for me yesterday; tell me what you are doing for me today. Clearly, they are saying to their elected directors and our policymakers that they want the interest rates of the Farm Credit System more reflective of current market.

So that means pricing new loans based on the money that you would go into the market and buy today. Now, it is going to take it probably 18 months in order to move the portfolio of loans we have.

And we are probably going to have to block the old ones off, set a new rate for new loans at some point, and begin that process, and then we will have to reduce the rates as those expensive bonds mature. And a significant portion of them will mature in the next 12 to 18 months, and will be of some real help to us.

But it means that we would go to incremental pricing, which is different. It means we would have differential pricing, based on risk and cost, which is different.

And those are not universally popular for a system that has operated for many years with one price for all, that is a major change. But clearly borrowers are asking for that as well.

And I hope that response to the interest rate question on the—if we were to do that immediately, obviously, we do not have the capital base to that right now, and I am sure our regulator under their capital directive would not allow it.

I think our projections that we gave you last fall are intact, we still have about $3 billion of that surplus. Clearly what happens to land prices, and asset values in the next 12 months will be very critical, to answer your question about when and if the Farm Credit System will need to come back for that safety net of financial line of credit that we talked about.

Mr. STALLINGS. Mr Chairman, may I have just 1 more minute?

Mr. JONES of Tennessee. You may.

Mr. STALLINGS. Let me just ask one followup. How much bad debt or losses were written off in 1985, that current borrowers of the system will have to bear?

Mr. SIMS. $1.1 billion.

Mr. STALLINGS. Thank you.

Mr. JONES of Tennessee. Thank you, Mr. Stallings.

The Chair recognizes Mr. Glickman for 5 minutes.

Mr. GLICKMAN. Yes.

I would like to ask any of the panelists, but perhaps Mr. Dean, or anybody else, there is a great feeling in my part of the country that Federal regulators who have suddenly become a little more flexible in some of the issues such as write downs and amortization, only became flexible when the oil and gas crisis began to affect the viability of banks, and not before then.

That is as long as it was just agriculture and the banks, those banks were affected for that reason, there was no flexibility, in fact, very, very stringent adherence to regulatory requirements. But the minute oil and gas problems began to affect banks in this country people started to get flexible.

I wonder if anybody might comment on that?

Mr. DEAN. I think that this was going in the place before that, before the big downturn came in energy. It was going in place way last fall.

Mr. GLICKMAN. You mean in terms of the Federal regulatory——

Mr. DEAN. Well, I don't know whether it was regulatory or whether it was through Congress.

Mr. GLICKMAN. Mr. Conover.

Mr. CONOVER. Well, I think in response to the energy problems that have developed, it is certainly an identifiable reason. Beyond that, H.R. 3868, H.R. 4267, probably had quite a little bit to do with it, too.

Recognizing that if they didn't make some capital leniency moves it may very well be legislated for them to do so.

Mr. GLICKMAN. OK. Well, there is some feeling out there, some kind of suspicion that until such time as the energy crisis added to and compounded the oil and gas to the agricultural problems, that the bank's regulating officials in this country were not as responsive as we would like them to be.

I do believe that they have become more responsive, however. I do see some genuine cooperation developing now between the Comptroller and the FDIC and the private banking system that I think we have long needed.

Mr. Sims, I would like to ask you a little bit about the Farm Credit System. The Wichita banks asked the Farm Credit Administration for authority to reduce interest rates. That was turned down.

Can you tell me why it was turned down? I realize you are not the Farm Credit Administration, but is this happening all over the country?

Mr. SIMS. Yes, there are a number of instances where that is being done. Our bank currently has a request before the regulator to change interests rates and we are awaiting—in my testimony I asked that we continue—we recognize that we have got to go through a transition, going from Farm Credit Administration being the head office of the Farm Credit System to arms-length regulator.

And as you know, we supported that very heavily. But we would ask that the banks be put in a position to manage our own interests rates; we think that is terrible important. The agency issued a capital directive, No. 1, approximately mid-January, mid to late January, and one of the things that requires for the majority of the banks in the system is that FCA give interest rate approvals.

Mr. GLICKMAN. But it just seems counterproductive if the banks are asking for some capability of reducing interests rates, and FCA is saying, no; that it is just going to lead to greater, greater exodus from the system and more, and more difficulty—you are going to have to survive. I mean, it is crazy, it doesn't make any sense.

Mr. SIMS. That is one of the reasons that we have adopted the resolution that I talked about in my testimony, to moving to competitive interest rates. We believe we must do that. We are working very hard with FCA to try to convince them of the need to make some of these interest rate moves that we are requesting.

Mr. GLICKMAN. Based upon your understanding of FCA, why do you think they have declined to give the banks the authority to lower their interest rates?

Mr. SIMS. What we are hearing from them is they are concerned about the amount of capital available to the system to help the weakest banks and, therefore, do not want to see us dissipate that capital through significant interest rate reductions.

Mr. GLICKMAN. Well, does this mean that some of the stronger banks are putting pressure on the FCA to resist relief to some of the weaker banks?

Mr. SIMS. I have no indication of that.

Mr. GLICKMAN. Now does the fact that we haven't named, we, meaning the administration, the many directors the Capital Corporation Board, does this render less effective the current regulatory structure of the Farm Credit Administration?

Mr. SIMS. No, I do not believe it does. Although we would encourage that those appointments be made very quickly. I think it does indicate the need to get the new FCA board appointed and confirmed.

Mr. GLICKMAN. Mr. Sims, I have heard a lot of folks in my area indicate great personal concern—Mr. Chairman, if I could have 1 additional minute—great personal concern about the viability of the Farm Credit System, even after the statute that we passed and the help that we tried to give you.

Where do you think you are going to be 6 months from now, or 1 year from now, with no change in farm income, let's say no real upward change in the pricing system of farm commodities?

Mr. SIMS. Well, clearly we believe the projections that we provided you last fall are coming true. The nonaccrual loans have grown, and last year as I mentioned, we wrote $1.1 billion. We set up heavy reserves.

It is at this point, we expect to have an operating loss to the system. We are currently looking at those projections so that we can evaluate what land markets are doing. Clearly, it is going to be a big challenge for us, Mr. Congressman, to work through these nonaccrual loans.

I think the indications that we gave you last fall continue to be accurate.

Mr. GLICKMAN. So, you will show obviously significant losses again this year?

Mr. SIMS. We will have loan write offs, as well as an operating loss.

Mr. GLICKMAN. Thank you.

Thank you, Mr. Chairman.

Mr. JONES of Tennessee. Thank you, Mr. Glickman.

And adding to that Mr. Glickman—I would say to you, Mr. Sims, that according to previous testimony, and evidence that we have at that time, it appears you may come to Congress asking for Treasury assistance before the year is out.

Mr. SIMS. At this point we doubt that that will happen in 1986. Clearly, what has been indicated to us is that the new FCA needs to be in place, the Capital Corporation needs to be in place and operating, and given the fact that the delays in the appointments, that will probably not be operating until midsummer, mid to late summer, so I think we are looking at that issue as being a 1987 issue rather than a 1986 issue at this point.

Mr. JONES of Tennessee. That brings good news to this subcommittee.

Mr. Thomas, did you have some additional questions?

Mr. THOMAS. I did, Mr. Chairman.

Mr. JONES of Tennessee. Proceed briefly, please.

Mr. THOMAS. That is difficult for me to do, Mr. Chairman, but I will try.

Mr. JONES of Tennessee. I have found that out.

Mr. THOMAS. Perhaps that will come in time.

Let me go back just a moment or two here. All three of you might want to—the bankers might want to respond to this.

But if you look at the farm credits portfolio across the United States, and you listed the loans that were made this year, those that you went along with without any need to change anything, that the guy came back to you, the farmer did, and you financed him, and you put that down as part of a percentage of what you loan goals are, and then you put down a percentage of foreclosures, the loans that you foreclosed on, and then if you put down a list of loans that you restructured, and by restructuring, I mean different financial arrangement than existed with this farmer and one under which by new provisions or new arrangements that you made, stretched out a longer or different combination to PCA and land bank loan arrangements, or different plans that the land bank itself has, the Springfield and other plans, with some dramatic differences in what I see in those loans, how many loans would fall in that latter category, restructured?

Mr. SIMS. I do not have the figures on the tip of my tongue for the system. Let me talk—St. Louis is very typical of the system as a whole—let me talk about St. Louis.

We have over 75,000 to farmers in our district; 5,500 of those loans are delinquent. Just under 1,000 of those loans are either in foreclosure or bankruptcy.

The other 4,000 are loans that we are doing exactly what you are talking about. Where we are restructuring through loan extensions, buying time, restructuring the business, as Mr. Conover talked about, looking at the Farmers Home Administration Guarantee Program, all of those kinds of options are being worked on on those 4,000.

Mr. THOMAS. Would any of the gentlemen like to give their figure, their idea?

Mr. CONOVER. If you would like a response in percentage of customers, or percentages of dollars, you will get quite a bit different answer. In percentage of dollars outstanding, I would say we would be in the neighborhood of 65 percent of the total dollars would be going through some form of restructuring process.

Perhaps, 35 percent might have been approved on more normal and ongoing kind of loan arrangements.

In the banking industry, broad scale, I think the percentage of turndowns and foreclosures has been limited in the 5 to 10 range from banks that have zero, to banks that had 20 to 25.

Mr. DEAN. I think as far as your restructuring, almost any borrower from a commercial ag bank that borrows very much money, I think you restructure him every year, in light of the earning capacity. Sometimes you almost always lengthen him out. So I would agree with Neal that a large percent of the dollars and the customers on the ag borrowers that borrow very much money, are restructured, one way or another. We have restructured a lot of them.

Mr. SIMS. I would concur with that in the Farm Credit System, particularly on the operating loans that you are talking about, clearly, that is being done all the time.

Mr. THOMAS. I hope sincerely—and I will close with this, Mr. Chairman—I hope sincerely that the facts bear that out, because this is the kind of evidence that I will be looking for, if that hopefully, unhoped for date does occur, when the Farm Credit Administration comes back here for direct confusion of cash, if that is necessary, of money, in the next year to 2 years. I will be looking certainly very specifically at those records of restructured loans versus those that were foreclosed, as to whether or not I am willing to go any further at that time.

I think we all need to recognize that that is the issue here, and whether we do anything to help commercial banks or not, I think, is going to hinge on that, as to whether Members of this Congress see that by their actions that we are going to do something to alleviate the pressure at farm level, and that we see the banks and the lending institutions willing to do their fair share in that part.

Thank you, Mr. Chairman.

Mr. JONES of Tennessee. Thank you, Mr. Thomas.

Mr. Cooper Evans.

Mr. EVANS of Iowa. Thank you, Mr. Chairman.

There are two areas I would like to pursue just a bit, if I may, with Mr. Sims, for just a moment, go back once more this business of FCA controlling interest rates.

I have a very clear recollection of the testimony when we were doing the Farm Credit System bill by the FCA, and this came up. They were asked, Do you have any intention of controlling interest rates throughout the system?

The answer was, no, we don't on a day-to-day basis.

Then I remember very clearly going on and saying, you mean to tell me that if in some of the district banks they dramatically reduce their interest rates in order to bring down their surplus accounts, and essentially spend them within their own district to get lower interest rates for their farmers, you would not interfere?

The answer came back loud and clear, oh, yes, in that instance we would, because we want to keep the purpose of that act, which was to retain the surplus accumulated throughout the system to help solve the collective problems of the system.

Now, my question to you is do you think they are going beyond that in their control of interest rates at the present time?

Mr. SIMS. I will speak for what they have done in our particular district. They are forcing us to justify that our capital will not be dissipated materially by the actions that we are proposing to take in our interests rates. I think that is where they are carrying out that responsibility that you are talking about, when they are taking the actions they are taking.

I am unfamiliar with the details of all of the other districts that have requested changes at been turned down.

Mr. EVANS of Iowa. So you wouldn't disagree with my contention that probably what they are trying to is to preserve that $5 billion in accumulated earnings over the many years that it can be used to solve the problem, rather than used to provide reduced interest rates to farmers in the prosperous districts?

Mr. SIMS. That is what they are telling.

Mr. EVANS of Iowa. Thank you.

One more question for the two private lenders.

We focused a lot today on the problems of the hard pressed borrower, that lower one-third, if you will, or the middle one-third.

We have had very little to say about that top one-third. And that is where the efficient producers are, efficient in an economic sense, not in any other sense.

What do I say to my highly efficient producers, who own nothing on land, who will cash flow their operating expenses at 170 percent in many instances, 160 percent, in that order, who come to me now and say, now, why is it that with a 9-percent prime rate and a 7-

percent discount rate, I am still having to pay 12 to 13 percent on operating loans?

When in any other segment of the economy across this country they would be getting substantially preferential rates by virtue of their excellent credit standing, and they are not getting any benefit for that excellent credit standing within the commercial banking system in the Midwest in this point in time.

What do I tell them?

Mr. **Dean**. Well, one thing that I would tell them is that basically that the country bank does not get its money on demand basis, as they don't buy funds as the city banks do. It doesn't fluctuate daily; we are locked in to a lot of things.

Mr. **Evans** of Iowa. If I may interrupt you.

Mr. **Dean**. Sure.

Mr. **Evans** of Iowa. Most of those farm banks have only about half of their total assets in loans of some kind. The rest of those assets are in some kind of other investments other than loans.

Your average return on portfolio in those banks is far less than the 12 to 13 percent. What are you getting on Treasuries these days; you are putting a lot of money in Treasuries that are 7 to 8 percent?

Mr. **Dean**. Or less.

Mr. **Evans** of Iowa. Yet you are charging the very best farm borrowers 12 to 13 percent on operating loans. And I think that is unconscionable. And I think that is going to come back to roost. I think you are going to see people like the saving and loans, who would like to get some of those high cost, or high return loans on short term, short maturities, moving into your business if you don't do something to protect your best customers.

The same problem with the Farm Credit System it is just a little bit further down the road. And I think you have got to respond to those needs out there or you are going to be in trouble.

I yield back the balance of my time.

Mr. **Jones** of Tennessee. Thank you, Mr. Evans.

Mr. Conover, did you want to say something?

Mr. **Conover**. Only that our industry is not really any different, Congressman, that is the banking industry compared to other lenders. We are in the same process.

In terms of explaining away the situation that is there now, the same reason that borrowers aren't paying prime rate today is the same reason that they weren't paying prime rate when prime was 22.

The fact is that the cost of restructuring agricultural debts has to be borne out in the capital accounts in some respect.

When FCA says the Farm Credit System can't reduce rates, it is to preserve capital that needs to be there to protect the assets to the organization, in trying to protect the depositors that we answer to. So once our capital is depleted to 6 percent, we need to retain those earnings as much possible to protect the sanctity of our own operation.

So, much the same answer is there, but we are going forward. In fact, in the banking industry now to do a long-term study of how we can serve agriculture and I think those are, with the incremental pricing, is in one of those areas.

Mr. Jones of Tennessee. Thank you very much, Mr. Conover.

Any other member of the subcommittee have additional questions.

If not, gentlemen, I apologize for the length that you have had to sit there, but think about us also—but I apologize to you because we are going to be here longer.

We do appreciate the testimony that you provided.

Without objection I am going to ask that the subcommittee members be permitted to contact any member of this panel for any future further questioning that we might have, if there is no objection.

Thank you very much.

May I say to the next panel, and then to the next panel, that after we get panel 2 in place, if somebody on panel 3 would like some lunch, feel free to go procure it, if you would like.

Panel 2, Mr. Dean Kleckner, president, American Farm Bureau Federation, Rudd, IA; Mr. Charles Frazier, director of the Washington office, of the National Farmers Organization; Mr. David Senter, national director, American Agriculture Movement, Washington, DC; and Mr. Cal Coulter, vice chairman, Tax and Finance Committee, National Cattlemen's Association, Bridgeport, NE.

We will take the witnesses in the order as they are on the witness list.

Mr. Kleckner, of the American Farm Bureau Federation, you are first.

We are glad you are here; and you may proceed.

STATEMENT OF DEAN KLECKNER, PRESIDENT, AMERICAN FARM BUREAU FEDERATION

Mr. Kleckner. Thank you, Mr. Chairman.

The Farm Bureau appreciates the opportunity to testify today on agricultural credit. I am Dean Kleckner, president of the American Farm Bureau Federal. I farm at Rudd, IA; my operation is 550 acres of corn soybeans and about 1,800 head of hogs per year.

For the past 5 years, agricultural finance policy has been driven by the "1 more year" syndrome. The goal has been to keep borrowers and lenders solvent for "1 more year" hoping that the debt-income situation would correct itself.

Since farm operators and lenders are partners and one can't survive without the other, actions were taken on the assumption that anything that would help one would help the other. This "1 more year" policy was based on the idea that the debt problems of agriculture were caused primarily by forces beyond the control of the farm operator.

Once these outside forces, such as high interest rates, strong dollar, low exports, declining land prices, and high production costs went back to "normal," everything would be fine. These outside forces were contributing factors, but not at the root of the debt problems, and changes in these forces will not eliminate the debt pressures.

Agriculture has run out of "1 more years." As a policy, that approach is now obsolete. Those short-term lenders who have loaned money on equipment and livestock to pay interest and principal on land, have said, "no more."

Most operators are reluctant to further mortgage land to cover unpaid operating expenses. Operators with the greatest debt problems have substantial amounts of nonworking debt that require the servicing of principal and interest but provide little, if any, cash flow to the business.

For 1986, the agricultural finance policy debate has been focused on the immediate problems of the one-third of commercial agricultural operators that hold two-thirds of the debt held by all farm operators. We heard that with the earlier panel.

About half of this group, 100,000 to 125,000 farm operators are at the point where substantial debt restructuring will be needed over the next 2 years to avoid liquidation, either voluntary or forced.

A substantial reduction in debt load or a reduction in the debt that has to be serviced out of current income is absolutely essential. Only this will bring long-lasting financial relief to stressed farm operators. For some portion of the farm operators, no reasonable amount of debt relief will be sufficient to deal with their debts.

Several months ago, the Farm Bureau set out to develop a debt restructuring plan to aid financially stressed farmers who, under the right circumstances, have the chance to survive.

The American Farm Bureau Federation has proposed a two-tier debt restructuring program to deal with long-term financial problems. The program would start with the farm operator and the lender analyzing the individual operation to determine how much debt could be paid under normal circumstances. That would become tier one debt.

On this tier one portion of the debt, the farm operator would pay the regular interest and principal payments over 10 to 20 years. The remainder of the debt would be put into tier two where it would carry an interest rate of 3 percent with no principal payments. As a portion of the tier one debt is paid off annually, the debt would shift from tier two to tier one until all the two-tier debt is paid.

An example that we use: A farmer has a $300,000 debt, and after he analyzes the situation with his banker, they decide that $200,000 can be properly serviced paying principal and interest. That is tier one. And the remaining $100,000 becomes tier two. And then that would shift into tier one as they pay off the principal in tier one.

The key here, gentlemen, is debt restructuring, not debt forgiveness. Now some steps are necessary to make the program work. Tier two debt must be monitored separately by regulatory authorities so that it is not discriminated against or classified against the capital of the financial institution.

Let me say at this time that we are pleased that the banking regulators have made two-tier debt restructuring, as well as other forms of debt restructuring, possible through issuing new regulations. As of March 28, the Federal Deposit Insurance Corporation, the Federal Reserve System, and the Comptroller of the Currency has sent notices to their banks to employ a common set of general supervisory policies to assist troubled banks.

These policies include capital forbearance, changes in the call report requirement, and a reaffirmation of the use of Financial Accounting Standards Board Rule No. 15. FASB–15 simply says that a loan may continue to be carried on a bank's books without any loss recognition if the loan is restructured in a manner so that it is probable and estimable that the borrower can repay the principal and interest so it at least equals the loan amount on the bank books. Therefore, our two-tiered debt restructuring proposal would fit.

Let me hurry on.

We emphasize that we believe these regulations, along with the reaffirmation of the use of FASB 15, could aid a high percentage of debt-ridden farmers. Most would agree that the regulators would not have taken these steps had not Congress, the Farm Bureau, and a few other groups put pressure on them to do so. And we heard that earlier.

Now as well as meeting and working with the bank regulators to achieve debt restructuring and capital forbearance in the past few months, we have been taking similar action with the Farm Credit Administration. Unfortunately, they have given us no indication that they intend to make any changes toward forbearing with their borrowers.

In fact, we hear on a daily basis, and your questions alluded to that, about FCS borrowers who have been foreclosed by the system, only to have the system sell the land to someone else, several hundred dollars cheaper, with lower interest rates, no purchase of stock.

In some of the cases, had the original borrower been given anywhere that kind of deal, he, too, could have a go of the operation.

Because of this attitude, we are asking Congress to help persuade the Farm Credit Administration and the Farm Credit System to practice forbearance rather than foreclosure. Senator Nickles in Oklahoma, introduced Resolution 122, just before the Easter recess, expressing a sense of Congress so that the FCA should take actions.

In addition, one of the members of your own committee, Congressman Lindsay Thomas, has introduced a companion resolution 310, and he mentioned that. We would hope that many Members of Congress would help Congressman Thomas in that area.

Concluding with five things that we think the FCA should do: They should make use of agricultural restructuring programs. Two, they should classify restructured loans as performing as long as the restructured payments are being made. Three, they should permit multiyear amortization of loan loss write-offs. Four, compare the cost of foreclosure on a loan with the cost of restructuring, if restructuring is less expensive, use it. And five, consider two-tier debt restructuring as one way to restructure debt.

We believe that unless Congress acts positively on this resolution or something like it, indicating their concern to the FCS, no progress will be made in changing their attitude from foreclosure to forbearance.

Thank you, Mr. Chairman, for the opportunity to testify.

[The prepared statement of Mr. Kleckner appears at the conclusion of the hearing.]

Mr. JONES of Tennessee. Thank you, Mr. Kleckner, for your good statement.

Next witness, Mr. Chuck Frazier, director of the Washington office of the National Farmers Organization.

Chuck, we are glad that you are here; and you may proceed.

STATEMENT OF CHARLES L. FRAZIER, DIRECTOR, WASHINGTON OFFICE, NATIONAL FARMERS ORGANIZATION

Mr. FRAZIER. Mr. Chairman, first, on behalf of my officers and membership of my organization, we want to thank you for having this hearing; we appreciate your interest at this time; and we believe that some further action on the part of the Congress probably will be necessary before this year is over.

I would like to start by pointing out that rather than work in general terms, broad expressions, on this whole debt problem, I have undertaken to spot three types of problems out over the country, working over the last couple of weeks, and I believe, in each case it is typical of problems faced by the average, midrange owner-operator that we want to keep in farming, if we can possibly do it.

This is what I am talking about. I picked up the lead on Governor Wilkinson's final statement and his message to the bank officers on the date that he retired from the FCA, I believe, it was March 28, he cited a problem of communication between the reorganized bank structures and the FmHA in dealing with money of these borrowers at the local level. I checked out some of the problems in a typical farming area on the coastal plains, on the east coast, Southeast. I went to the Middle West. I talked to some people in Mr. Coleman's district. And I have had some calls out of Idaho.

To outline the three problems quickly, I think, even with good intentions on the part of FCS, it is apparent that they are trying to push some of their borrowers, who may have some problems but who are still credit worthy and should survive in farming, from the system over to the FmHA.

Specifically in the southeast example, with which I am working, it is a nice family. The man is well educated. His wife is a schoolteacher.

They are farming 640 acres. He sold off 250 acres in the last 2 or 3 years in order to rebalance his organization, his structure, and survive, when FCS said no to him. He went to the FmHA. They cited the fact that he hired two men in his farming operation through the summer season and declared that he did not look like a family farmer to them, so they did not want to handle his loan. This definition of a family farmer is really off base out there in the country.

They are taking many different approaches on it, and some very creditworthy, sound people are being denied operational money to go in the fields right now, to get this crop planted.

A second type of problem moving through the middle west area, is largely a result of some heavy borrowing in the 1970's, and some bad weather, but the creditworthy group of this midrange type farmer that is in trouble there is in trouble because the so-called guaranteed loan program is really not being made operational. The people walk into the banker; they try to work these things out. It is typical for the bank to say to the man, look, if we are on a 10-year loan, if we are working a long time credit arrangement with you, then maybe it is worth going through all the redtape and the rigmarole to get a man's production records for the last 5 years, assemble all the legal checks. A banker tells me it takes him from 2 to 4 days to work one of those loans, now they simply cannot go through that just to put up some operational money for this year's season.

Very briefly, the third type of problem I encountered in the State of Idaho, they have 8 or 10 counties out there that have been designated as a disaster area because of bad weather and a heavy freeze that knocked out the potato crop last year. They need those disaster loans, but for some reason FmHA is really not extending any of the loans. And I give you again, a very clear-cut example to illustrate the problem.

Two brothers farming in the same community, typical family operation for the area, it is irrigated potato production; they need laborers to move pipe in the summertime in order to make a crop. One of the brothers has five sons. He has got the family labor supply problem whipped on a cheap basis. He is eligible for a loan. He is getting a disaster loan.

His brother farming in the same community is raising five daughters and has to go in the labor market and hire people to help him move irrigation pipe, and he is told that he is not a family operator, and they are not going to make him a disaster loan to put that potato crop in this year.

Now, what this adds up to is that, sure, these good people running these agencies offices are badly pressed; they know they have limited resources to work with; they do not have direct operation loan in FmHA. They don't have the money for them; they are not making the loans.

And the guaranteed loan program is not working. Some of these excuses about defining a family farm, and some of the other things that I have mentioned, are really just used as excuses to backoff and withhold funds from some of those midrange operators that deserve a chance to borrow some money to go in the field this year, because they are good credit risks.

To close it quickly, we are favorably impressed with the provisions that have been set forth in H.R. 4267 and H.R. 3868, and we would be happy to work along with you over the next few weeks, if you wish, to develop legislation.

I subside from there. I do set forth some principles on pages 4 and 5, that we believe should be encompassed in any new legislation.

With that, we will try to be helpful to you.

Thank you.

[The prepared statement of Mr. Frazier appears at the conclusion of the hearing.]

Mr. JONES of Tennessee. Thank you very much, Mr. Frazier, for your statement. We do appreciate your offer to help, and know that you will do that very thing.

Our next witness is Mr. David Senter, national director of the American Agriculture Movement here in Washington.

David, thank you for being here; and you may proceed.

STATEMENT OF DAVID SENTER, NATIONAL DIRECTOR, AMERICAN AGRICULTURE MOVEMENT, INC.

Mr. SENTER. Mr. Chairman, it is my pleasure to appear before this subcommittee. I want to commend yourself and this subcommittee for once again rising to the occasion in holding hearings. I want to also commend Mr. Panetta and Mr. Bedell for continuing their efforts to solve some of the problems that we continue to struggle with on the farm.

Farmers are continuing to face falling commodity prices; falling value of all of the assets, which are putting many, many in a situation where they cannot meet the criteria to provide financing and refinancing for their operations, that being the cash-flow requirement.

Mr. Jones, I guess that after listening to the bankers testify in the last panel, I have to take exception to their positions in that we very much support your position in looking at the 50 percent advance CCC loan. There is no other program that will cross all lender lines and provide the cash flow necessary to continue on with this crop.

It would be immediate. It could be carried out with the existing personnel and programs. It would benefit all concerned that would allow many farmers to catch up on delinquent interest, principal, cover operating loans, and a whole host of areas.

I guess that also our organization has been supportive of extending the write-off period for commercial lenders to 10 years. We may now, though, we may take another look at it because unless we can get support from lenders to support farmers in our income and program, such as the advance loan, I see no need to put effort into solving their problem unless they are going to help solve ours.

We believe very strongly that debt restructuring should be mandated to stop the Farm Credit System and others from foreclosing on borrowers and then offering cheaper interest, and better terms, and no capital purchases, and a whole host of programs that existing borrowers have not been offered.

You know, it is unfortunate, but we have heard quite a bit of conversation today in this hearing almost writing off the bottom third of the farm borrowers. That is 700,000 farmers in this country.

They provide the income and business for over 100,000 mainstreet businesses, using Commerce Department statistics. Now our organization is not willing to write off 700,000 more farmers in this country and that is why we are here saying we need the advance loans. And people need to start talking about farmers and numbers here instead of just talking about the bottom third, and middle third, and so on. They are people; they are families; they are communities, and we have to face up to that.

I just finished a five-State tour the last week and a half, at farm meetings all over the country, and seems as though from these farm meetings that you come up with a lot different picture than you hear from other testimony. Over half of the people coming out are not financed for their operating loans this year.

Many others have only been provided a small part of their operating money because you find Farmers Home supervisors struggling to give a little money to everybody, and sometimes half financing is as bad as no financing.

I would like to enter into the record that we have met with bankers in all of these States on why the loan guarantee program is not working. They gave me a list of rules that they are given that they have to comply with in order to use the guaranteed program, and in many cases it directly violates lending procedures of that bank, it is complete contrary to the way that they do business. I want to enter these rules into the record because that is the reason bankers cannot and will not use that program; it is too complicated.

Mr. **Jones** of Tennessee. Without objection it will be made a part of the record.

Can you identify the States in which this is found?

Mr. **Senter**. Yes; we have met with bankers in South Dakota, Nebraska, and Minnesota.

Mr. **Jones** of Tennessee. Thank you.

Mr. **Senter**. Mr. Chairman, we also found a large problem in loans that were pending and not acted upon by Farmers Home Administration. We documented some cases where operating loans had been pending for 12 months, never receiving a yes or no.

We want to renew our call that there needs to be a time requirement on operating loans, that FmHA should give that person a yes or a no within 3 months or that loan is automatically approved. They just have to give that borrower an indication of whether they can go along or not within a timely manner because operating funding has to—they have to get them on time to plan.

Thank you, Mr. Chairman; we look forward to working with you to solve the problem.

[The prepared statement of Mr. Senter appears at the conclusion of the hearing.]

Mr. **Jones** of Tennessee. Thank you very much, David, you have been very cooperative, and we do appreciate it.

The next witness is Mr. Cal Coulter, vice chairman, tax and credit committee, National Cattlemen's Association.

Mr. Coulter, welcome; and you many proceed.

STATEMENT OF CAL COULTER, VICE CHAIRMAN, TAX AND CREDIT COMMITTEE, NATIONAL CATTLEMEN'S ASSOCIATION, ON BEHALF OF THE NATIONAL CATTLEMEN'S ASSOCIATION, NATIONAL ASSOCIATION OF WHEAT GROWERS, NATIONAL CORN GROWERS ASSOCIATION, NATIONAL COTTON COUNCIL OF AMERICA, NATIONAL GRANGE, AND NATIONAL PORK PRODUCERS COUNCIL

Mr. **Coulter**. Thank you, Mr. Chairman, and members of the committee.

I am Cal Coulter. I am a farmer and a rancher from western Nebraska. We have submitted a written statement in testimony for the National Cattlemen's Association, National Assoication of Wheat Growers, the National Corn Growers Association, the National Cotton Council of America, the National Grange, and the National Pork Producers Council.

I am not going to reiterate what is in that statement and waste your time. I would like to add to it and amplify it a little bit, as a respresentative of the National Cattlemen's Association, and my own personal observations in this area.

Mr. JONES of Tennessee. Without objection you entire statement will be made a part of the record.

Mr. COULTER. The first thing I really want to emphasize to this panel is that there is a crisis in agriculture credit. It is a real crisis. It is out there; and it isn't going to go away. We have a record number of "for sales" in my area, and I think, generally across what we consider the farm belt, and the cattle areas, and certainly in the South.

The disturbing thing about this is it is still on the increase, and there is not a lot out there that is going to show us that it is not going to continue to increase. Between having too much credit available to us in the past, seeing commodity prices drop, and watching our interest costs increase, and increase dramatically in the last 5, 6, or 7 years, we have created gigantic losses out there in the country. The financial institutions are our partners in this loss, and they are now starting to try to work those through as they have to realize them and have to recognize them.

The farmers and the ranchers have already lost the equity, or lost the money, and it is not filtering down through the system. Main Street of rural America is feeling this loss; and we are watching businesses close. We are seeing more and more empty buildings.

Those businesses are not coming back. Those buildings will not be filled again by a commercial enterprise. They make a wonderful low cost site for a senior citizens center or something like this. But commercial activity is declining, and it is not going to be restored barring some sort of a miracle.

Both the people in agriculture and people in the financial institutions, the bankers, farm credit, whatever, most, in some manner or another, address this loss. For agriculture the primary and immediate need is lower costs of interest. The rates are too high.

We cannot afford to use the amounts of interest that we need in agriculture with a 13-percent price tag. There is not that kind of a return in agriculture.

So we either borrow too much money and go broke, or we don't use enough money to make the operation work efficiently and properly. If could obtain lower interest rates in the neighborhood of prime, for instance, this would reduce the rate of failure of agricultural enterprises.

This would tend to stabilize the land values because we would see some interest in buying land at 9 percent that simply is not there at 13 percent. We would slow the departure of the family farm from the rural scene.

But in order to have those lower interest rates, we are going to have to address that loss that is out there. Quite a bit of the reason for those higher, and too high to use interest rates, impractical levels, results from that loss trying to be absorbed by financial institutions, the increase in the rates for reserve losses against losses, that is quite a bit of our problem.

Another point that I think hasn't been touched on a great deal but we need to mention, it is unlikely that the industry, the economy, the whole populous of the United States is going to prosper and grow as long as we have a segment as large and as important as agriculture in a depressed economic state. You simply can't lose that much money with that many people involved and have the overall economy grow and prosper.

I want to oversimplify here, Mr. Chairman, to make a point. There are two classes of people in agriculture today. The ones that are broke and the ones that are going broke.

It is ironic that we live in a country with the tremendous productive resources that we have, the innovative and hard-working farmers, the technology, all the things that we need and we produce a tremendous supply of food, it is ironic that the production of that food is part of our problem and results in the depressed state of finance out there in the agriculture sector.

I wonder what the situation would be if we had 90 percent of our needs production, a 10-percent shortfall. I suspect every farmer in the country would be prosperous. But we don't; we have an oversupply and an overproduction, and it is breaking us.

The failure that we are looking at is not a failure of agriculture, it is a failure of our political and economic system that deal with the plenty that we produce, the plenty, and the most basic commodity produced, and the absolutely necessity to mankind.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Coulter appears at the conclusion of the hearing.]

Mr. **Jones** of Tennessee. Thank you very much, Mr. Coulter, for your statement. We will continue to work with you too, as you have in the past with this subcommittee and this full committee.

Now for a period of questioning since everybody has been heard, I have one that I am going to address to the panel, and then I will defer to Mr. Coleman for any questions that he might have.

You gentlemen have been on the scene, your members are on the scene, you know what their attitudes are regarding the 1985 farm bill that we passed in December. I just would like to ask each of you individually, on a basis of 1 to 10, how do you rate the bill?

We will take you in order of how the subcommittee responded.

Mr. Kleckner, you are No. 1.

Mr. **Kleckner**. Is 10 perfect and 1 bad.

Mr. **Jones** of Tennessee. I beg your pardon?

Mr. **Kleckner**. Is 10 the high number?

Mr. **Jones** of Tennessee. Yes.

Mr. **Kleckner**. Seven.

Mr. **Jones** of Tennessee. Seven.

Mr. Frazier.

Mr. **Frazier**. Well, Mr. Chairman, I have to give it about a 2½ or a 3. As you know I am not an admirer of the policy that lowers loan rates and prices. I hope that exports will bail us out and everything is going to be great by-and-by. We are going broke in the meantime, as the previous speaker just said.

Mr. **Jones** of Tennessee. 2½ or 3, which?

Mr. **Frazier**. Make it three, it is a round number.

Mr. **Jones** of Tennessee. Mr. Senter.

Mr. **Senter**. Is there anything lower than one?

Mr. **Jones** of Tennessee. Minus one.

Mr. **Senter**. If it wasn't for some of the conservation sections and certain areas, I would have to give it a one. But I guess I would give it a two, because there are a few programs unrelated to price that are fairly good in the bill.

Mr. **Jones** of Tennessee. Mr. Coulter.

Mr. **Coulter**. I guess probably the farm bill doesn't impact us all alike. Certain provisions of that bill have had a very negative effect on the cattle business. I think the dairy buy-out provision that we are getting very sensitive over in the beef cattle area.

I found that some of the provisions relating to wheat, which is an area in this that I participate in, have not been all that bad. I think that it has a rather limited life, it is going to run out soon. But this first year or so of the wheat program is not going to be devastating to my personal operation.

Again, I think the conservation thing that was just mentioned is a very attractive feature. The failing in that particular feature is that it is not a firm contract for 10 years; it is a firm bid the first year subject to reduction over the 10 years.

If you start in and reduce even by a relatively small percentage for 10 years, you may not end up with very much. I would hope the people signing those contracts aren't going to end up with Government money in the ninth year. I would hope there would still be some payment left.

Overall I think it is an attempt to do something in a situation that starts out being terrible, and we have not been able to improve it very much in the past with farm bills. Maybe this will work. I certainly hope so. We cannot afford to drop the whole farm economy.

Mr. **Jones** of Tennessee. So where would you rate the bill?

Now, I want to remind you, too, before you rate, that your testimony relates to the National Cotton Council, who has been very favorable toward the legislation.

Mr. **Senter**. Without implicating my friends and partners in this, a personal opinion, I would have to say in the five or six range, good and bad, mixed bag type thing, however.

Mr. **Jones** of Tennessee. Thank you, sir.

Now, my same question that I asked the other panel. If the administration would go ahead, the Secretary of Agriculture, and use the discretionary authority granted in the farm bill to implement the advance CCC Loan Program to farmers, what would be your reaction, Mr. Kleckner?

Mr. **Kleckner**. The advanced loan?

Mr. **Jones** of Tennessee. Yes; the CCC loan.

We had a discussion with the Secretary, as you recall.

Mr. **Kleckner**. The Farm Bureau is basically in favor of that, Mr. Jones.

You asked the first panel that question; I sat back here and just did a little calculation. On the average size Iowa farm, 300 acres, of which they planted 150 in corn, which would mean that they were in the program this year but they had a corn base of, roughly, two-thirds, if that farmer got 120 bushels an acre, he got 18,000 bushels, and put in a loan at $2 a bushel, $36,000, half of that, as you suggested, would be $18,000 he would get the advanced deficiency payment on.

If he would say 6 percent, that is the CCC loan rate, compared to the average commercial rate, 6 percent on $18,000 is $1,080 for the year, he would save for 6 months, about $540. I would say it would be better in his pocket probably than somewhere else. It may not be the big bonanza that some people think, but it would be helpful; and we support it.

Mr. JONES of Tennessee. Mr. Frazier, with a rating of three for the farm bill, would this raise your rating any if we could——

Mr. FRAZIER. Well, it is favorable. Yes, Mr. Chairman. I prefer that good lines of credit extended over a longer period of time were available to those people, with direct operation loans, and so on. But absent loan money that we need then an advance of the commodity loan money would certainly be helpful.

Mr. JONES of Tennessee. David, you have already expressed your opinion.

Mr. Coulter, how do you feel about that?

Mr. COULTER. It is a little bit out of my area, Mr. Chairman. We do have a farm policy committee which probably should be anwering this. I did make a note while the discussion was going on, from a standpoint of logic, advance payment helps today's problem, but it also creates a problem for tomorrow.

Mr. JONES of Tennessee. There is not doubt about; you are absolutely right about that.

But today is what we are concerned about.

Mr. COULTER. I think if the thing were working correctly, and I believe we have alluded to this up here, is if we had the lending institutions operating properly, if we knew there was going to be a payment in the fall, or whenever, a line of credit could be extended based upon the farm program. And I believe a lot of that is being done.

So what we are talking about is the differential here between getting that payment now and saving the interest till fall, not denying the credit.

Mr. JONES of Tennessee. I think Mr. Kleckner's statement was really good in that regard because it does save a good deal of interest.

Thank you very much, gentlemen; I appreciate your response.

Mr. Coleman.

Mr. COLEMAN. Mr. Chairman, I don't have any questions.

But I think each of the panelists' testimony is very good. I think all of them had some ideas that we can look at, some of which now have been helped by the regulatory changes that have been made and previous noted.

Just commenting on your question there and, I guess, the only one who voted against the farm bill who is present, these gentlemen must agree with my position, and recognize the good thing that was in that bill was what you and I put in there, the conservation reserve program, the sodbuster legislation. We don't need to plow that ground again.

It is already past, but I think it does point up that we could have done better in that farm bill than what was done, and that's why I voted against it.

I want to thank you gentlemen for coming today and participating in these hearings.

Mr. JONES of Tennessee. Thank you very much, Mr. Coleman.

Mr. Gunderson.

Mr. GUNDERSON. Thank you, Mr. Chairman.

I should be the one, I guess, to do it, with my good friend Cooper sitting to my left, so I will let him officially do it. But I want to begin by saying that I think that is the first time I have had chance to hear Mr. Kleckner testify. And got to tell you from Wisconsin, we are indeed delighted that someone from the Midwest is heading your organization.

I was giving Webb Franklin a rough time that we have had too many southerners here. It is great to have someone from our area here, and I do appreciate that.

I would like you all to respond. I met with some farm people last week in my district, back home, and there myriad of suggestions and requests. I said, prioritize; I said, frankly, under Gramm-Rudman we are not going to get the kind of money you and I would like to have in an ideal situation. Likewise, we are not going to get a lot done in the credit area.

What is most important?

Is advance loans most important; is interest buydowns most important; is debt restructuring legislation flexibility for farm credit system, et cetera, most important?

Can you kind of list for us, all of you, the priority ranking of some of these issues so we know what is most essential in the next 30-60 days that this Congress tried to do to assist agriculture in the credit area?

Any comments from anybody?

Mr. KLECKNER. Mr. Gunderson, it seems to me that you probably got a mix of answers, because it depends, as somebody else said here, where you are coming from as to how you perceive the farm bill or what the problems are. I think 1985 was the year of the farm bill; the other bill expired. It worked all year on it. Farm credit was just as critical last year, almost critical at least as this year, but farm bill was the issue of 1985.

I think farm credit is the issue of 1986, frankly, what this committee is meeting on. It may not be for every farmer or every section of the country, if you are a cattle feeder, cattle raiser, and hog raiser like I am, the dairy buyout and the effect on the red meat market is pretty critical today, and maybe will be for a little while. But it seems to me that the farm credit issue has got to be addressed, not only for the next planting time, and half the country is still planting, I meant the planting belt has move half, up the country, not all the planting can be completed in the South. But not only for this spring, but for next summer, winter wheat planting starts in the summer; that is in this year yet. And then on into the winter, as the fall fertilization and go on for the 1987 crops, this issue, farm credit, the debt restructuring to keep the 100,000 to 125,000 farmers that I commented on, that we see, and most agricultural economists agree that it is about that number, the highest number of those possible in agriculture, that is the issue that Congress and the lenders have to address, and just what this subcommittee here does, it seems to me, in the next few weeks, is going to very critical to a lot of farmers in this Nation, not only this spring, but on through the year and next year.

Mr. **Frazier**. If I could comment quickly, Mr. Gunderson, it seems to me that Mr. Kleckner was very close to it. I believe we need some action from this committee right now to push the Farmers Home Administration to come on with what loans they are going to make; move. We have got too many people out there that are just held in never-never land, and they need financing right now if they are going to get those fields planted this year.

Mr. **Gunderson**. So you are really saying the No. 1 issue is not advanced loans restructuring interest buydowns, the No. 1 responsibility of our committee has got to be work with Farmers Home to implement the money they got in the programs they got as soon as possible?

Mr. **Frazier**. Use the authorities that they have; use the funds they; and let's get this thing moving now, and then once that is underway, I would encourage the committee then take a good look at the bills that you have before you and see what we may all contributed to, what we may develop to restructure farm debt for that third of the producers that are still in very deep trouble out there.

Mr. **Gunderson**. OK.

Mr. **Senter**. Mr. Gunderson, I would like to say that I would hope that the advance CCC loan would be in that same push on Farmers Home to fund the direct program, the restructure, and all because it is in the law. All they have to do is implement it tomorrow. And there is no other way to get into the farm credit system commercial borrowers, there is no other way to cross all of those lines other than this advance loan. Plus it has an interest buydown automatically because it is cheaper interest. And that has got to be a package and this committee can move that immediately knowing that it is only short term because the higher price is the only thing is going to solve this problem for anybody.

Mr. **Gunderson**. Mr. Chairman, can I get just 30 additional seconds?

Mr. **Jones** of Tennessee. Yes.

Mr. **Gunderson**. Thank you.

I just want to make a comment to Mr. Coulter, that as soon as the chairman asked you to rate the farm bill with the whole herd buyout starting last week, I knew I was in trouble. I just want to pledge to you and Mr. Kleckner, I have met with my cattlemen is one of the reasons I walked out at one of these earlier times, I stand ready to try to accelerate those purchases by USDA of the red meat to help you as well. If we can get 200 million bought now, the second 200 million the first of the next fiscal year, beginning October 1, or shortly thereafter, I think we can do a lot to respond to some of the legitimate concerns the cattlemen have.

Thank you.

Mr. **Coulter**. Could I respond to your question; or are we out of time, Mr. Chairman?

Mr. **Jones** of Tennessee. Surely.

Mr. **Coulter**. I think we have two different things we are looking at. We are looking at short term versus long term; we are looking at mechanical devices versus solving the real underlying problem.

Prior to planting time you need to do anything you can to get anything that will work to work, and get the crop in the ground.

Having done that you are free until August 1 or September 1, but the basic underlying problem is still there. First of all there is a lack of profit in agriculture.

If we can't get some profit into agriculture then we are going to have to reduce the costs. The cost factor that is the most devastating is interest because it impacts those people who are highly leveraged, and we have got to reduce the cost of interest to them.

So we have got to do something about the loss before that can come down. These are long-term serious problems.

Mr. **Jones** of Tennessee. Thank you, Mr. Gunderson.

Mr. Cooper Evans, you are recognized.

Mr. **Evans** of Iowa. Well, thank you, Mr. Chairman, and following along some of the thoughts that Mr. Gunderson expressed, I do want to take this opportunity to welcome my constituent, Dean Kleckner, here today. And since he is my constituent I hope the rest of you will forgive me if I sort of focus on him a little bit here for a minute or two.

But I was very pleased to see the emphasis on debt restructuring in your testimony, and I agree with you absolutely, that a two-tier or some similar method of encouraging that restructuring, and I notice that you take account of the need to get the Farm Credit System involved in this sort of thing too.

And again, I agree with you strongly. And I think you recognize that when we were trying to write the Farm Credit System bill, the Treasury strongly opposed us allowing the Farm Credit System to do some of the things that they are now allowing the banks to do, and I am encouraged that you are pushing on this, too.

And I just want to say to you that I had the privilege in the last several days in visiting at some length with the Under Secretary of the Treasury on this general subject, and ask the question should not those same forbearance type provisions and encouragements for restructuring be made available to the Farm Credit System. And his answer was, yes, the Treasury does not resist.

The only question, I think, now is exactly how do we go about getting this in place, and does the law as it is presently written allow the Farm Credit System to do this; or do we need some changes in the law. I would encourage you and the rest of you to pursue that matter with some vigor because I don't think there is any policy opposition at the highest level to getting this done, we have just got to get it done, and that requires some well-delivered speed.

To move on another area, Mr. Kleckner, in the earlier panel, and I know you were here, the need for a secondary market of long-term real estate debt came up at some length. And we heard a spokesman for the life insurance industry talk the need for doing this.

You in the Farm Bureau are in the life insurance in a very substantial way, and I don't think to my knowledge you have ever engaged in the retailing of farm loans in the past; and I don't take issue necessary with that policy, but my question to you is if there were a guarantee program and a repackaging and a secondary market, do you think the Farm Bureau insurance companies would be willing to invest some of their portfolio in that sort of guaranteed loan, and thereby indirectly help the farm credit situation?

Mr. KLECKNER. Mr. Evans, I guess I don't know. I think that a guarantee like that would certainly it more attractive from an investment point of view, from the safety point of view.

I was intrigued by your questions and their comments that they made in regard to your questions on this. There apparently is a need for that in the country.

Mr. EVANS of Iowa. It would seem to me, in view of the shortage of time, the Farm Bureau Insurance Co. ought to think hard about how they could put some of that money back in the financing of agriculture in a manner that makes good sound business sense to you, and might help the agricultural economy.

And it would seem to me that a guaranteed second market would enable you to do that as a wholesale purchaser on the secondary market as opposed to getting the retail business of long-term farm lending. I would encourage you to have a look at that.

I thank you, Mr. Chairman.

Mr. JONES of Tennessee. Thank you very much, Mr. Evans.

Mr. Thomas, you are recognized.

Mr. THOMAS. Thank you, Mr. Chairman.

Let me apologize to the members of the panel for being called away. It seems that like many other members, that on the day that very important things happen, they happen on all the committees that we are on and on the floor as well, things that I have been involved with.

I have read over the statements of most of this panel, and I particularly want to say to Mr. Kleckner that I certainly appreciate your statement, and I appreciate the work that the Farm Bureau did on this proposal.

I want you to know that I introduced yesterday, House Concurrent Resolution 310 on the House floor, and did it with tremendous pride and confidence, that it is a very good suggestion that I hope that I will be able to spur enough of Members' interest in this to make this possible to pass this legislation.

I would like, if this is in order, to simply as at this time, if what you have heard here this morning, since this proposal is one that I am supporting and have great confidence in, from the comments made from other panelists, and I don't think this is out of order to ask one panelists to make comments about others, but I would just like to know what you feel initial response of, say, those who spoke here on behalf of farm credit and the commercial banks, what their reaction to our proposal is going to be.

Mr. KLECKNER. Mr. Thomas, first of all, we really appreciate your efforts in this area, they are timely and we believe right on target, and apparently you are getting good response from your constituents here or other people in the House.

I was pleased by what I heard here this morning. I did flag one thing that—two of the bankers were from Iowa and I do know Mr. Conover personally, and the other one I did not—saying, I think, what I heard them say was they like what they were hearing but they were wondering what the field regulators were going to interpret that and put in practice. I think that is something that all of us have to keep on top of and flag.

Again, I happen to be a Farm Credit System borrower, and I heard Mr. Sims say some things I would like to hear. I am in the Omaha district, not the St. Louis district, but what we are hearing from the country is not what I heard Mr. Sims say this morning, that it is not being followed through on that they are still being tough. And you will notice the last part of my testimony, I think was slanted very much at the Farm Credit System.

The commercial lending system seems to be doing what they need to do to implement what we are talking about. The Farm Credit System says, we are, too, but it hasn't gotten out there from what I am hearing.

Mr. THOMAS. I have to agree with you; and that is the indication that I am getting from my constituent input as well. I will tell you that I have excellent response from my colleagues so far on the resolution that I introduced yesterday, concurrent resolution. I hope that this interest will continue to build.

I just want to say that I agree with you in this regard that there just has to be an alternative to the foreclosure procedure which is, let's face it, that is one of the alternatives open to lending institutions. When I looked at some of the repayments structures yesterday what I found was that many of these loans that were being foreclosed on had already in the course of our life had paid in interest far in excess to the principal of the loan. I am not an accountant, but I begin to sit down and wonder when I see what is being accomplished by institutions who insist on the foreclosure route and particularly in the case of farm credit. I have very serious doubts that anyone can show me in the hard, cold figures that the foreclosure procedure and that step is better when there is the alternative of restructuring.

I do think there is some great parallel here between this idea that as they turn around and sell this land out of the properties that they are holding that they are, of course, selling that at current market price, they are doing it without requiring stock. They are doing it at lower interest rates.

If you took that difference in the cost of the foreclosure to the system, and what you are making the new loan at, I think within those parameters right there we can find ample justification for looking more directly at the refinancing and restructuring process. I have to say, I appreciate your coming here with your testimony. I see other nods of heads around the room, not just on the panel, but I do not think the land bank and validate or that farm credit and show us in hard, cold facts that they are avidly pursuing that process of restructuring and refinancing over the foreclosure route.

And I want to reiterate my statement that I think that will be the telling decision as whether or not I hope the majority of the Members of the Congress continue to go along this route, because as we were told, he said they stated clearly that some members and some borrowers did not want to have to pick up the cost of those more risker loans, and this is to be understood. But the truth of the matter is that when we are involved at the Federal level in helping farm credit or anyone else, we are doing this broadly across the system and across the country to try to help all people being affected.

In that category of those who are being adversely affected in this credit thing are people who have been driven there by conditions totally beyond their control, from weather to excessive cost of interest, to the works that have been out of there.

So I think that we have to forget sometimes what is best for one small sector and section of the country and realize that either our provisions are going to affect farmers broadly and at large or why should the Federal area even be involved in the farm credit to begin with.

Thank you, Mr. Kleckner.

Mr. JONES of Tennessee. The time of the gentleman has expired.

That concludes the subcommittee questioning, I suppose.

Does anyone else have a question?

Mr. Panetta, do you have something that you would like to add?

Mr. PANETTA. Thank you, Mr. Chairman. I appreciate that.

Just a couple of areas. One, I would be interested in these new regulations that have been issued by the various Federal Reserve banks, et cetera, et cetera—the concern I have is that doesn't translate to the farmers, it is nice to have the banks have that convenience but one of the concerns that I have is I see nothing that converts that in terms of benefits that flow to the borrowers. That is one concern.

And second, I would like to have your view about the interest buy-down program which is in place now, because there are some concerns evidently about the various requirements that are built into it that give me the impression that that interest buydown is not going to be used very much.

I would just like to have your reaction to that as well.

Mr. SENTER. Mr. Panetta, it would appear to me that unless a program is put in place to use interest subsidies or something to force the banks to pass that on down to the borrowers, the restructuring. If they could, in fact, just use the programs to write off their loan losses and actually not help the borrowers at the grassroots level.

So it just seems like a program that uses the interest subsidies and those kinds of programs, that that criteria has to be built in to force them to restructure that debt so the benefit is passed on down instead of just solving their problems.

Mr. FRAZIER. I agree with the concern you just expressed and I would amplify it a bit this way. From different areas of the country I get the definite impression that the Farm Credit System people who have been open with us and discussed these problems with us, and so on, but that they really will not move to buy down interest rates or extend more favorable terms except from a man that they have already foreclosed and when they are going to release or sell the property.

It would be most important if they would apply some of the same principles in dealing with the man, leave him on the land, give him the chance to restructure the loan, and pay it off, and in the long run I think it would cost them less loss of capital. But they just simply are not coming through on that.

Mr. KLECKNER. Mr. Panetta, I would respond that we have to in the Farm Credit System keep the effort on as everyone here agrees, for forbearance rather than foreclosure. And as I said, I don't see it yet to any degree at all in my area, the Omaha district.

Back to your first comment on the regulatory changes. It was my understanding that for those things for the banks to be allowed to go under the 6 percent capital requirement, they had to do it as restructure, that they wouldn't be allowed to go below 6 percent, down to 4, even to maybe 3, I understood, in some cases. It had to be as a result of restructuring for the regulators to approve it.

If that is indeed true, and we need to keep watch on that, that apparently is the teeth for the regulators to say you are just not to get out from under debts you have, you have got to help farmers. But an excellent point and one that we would support.

Mr. COULTER. I think the restructuring programs, and the buydown programs, and things of that nature, are things that are difficult because they change our thinking and our approach. They take time, obviously. The communication in Farmers Home between the people on the top and the people out in the field is not what it should be. I think in some areas it is working quite well, and it is being utilized.

And in other areas, it is practically totally unutilized. This will change with time and with a few gentle nudges and little oversight from committess like this.

I used to serve on a Farm Credit board, and Land Bank board, in the Omaha district, I refused to allow my name to be submitted again for consideration when my term was up. I have developed a negative attitude toward farm credit, farm credit policies, the way they do things. In some way or another the Farm Credit System has taken on a life of its own, totally related to the business that they are supposed to be involved in and have a lack of sensitivity, perhaps, to the farmer-borrower needs.

That is probably all I have to say about it.

Mr. PANETTA. Thank you.

Mr. EVANS of Iowa. Would the gentleman from California yield?

Mr. PANETTA. I would be happy to yield.

Mr. EVANS of Iowa. You know when we wrote the Farm Credit System bill in December, we were not allowed to by Treasury to put into that bill a number of things that would have encouraged restructuring as opposed to foreclosure. Most of those incentives to restructure have now been granted to commercial banks, or are in the process of being granted.

I think it is vitally important that we, either administratively, or through legislation, insure that those incentives to restructure are now available to the Farm Credit System. And I don't recall whether you were in the room or not, but I inquired of this with the Under Secretary of Treasury the other day, and he assured me that the administration no longer has any opposition to doing this. So I would certainly like to join with the gentleman in trying to get that accomplished at the earliest possible date.

Mr. PANETTA. I thank the gentleman and I think that is an area that we have to address.

Thank you, Mr. Chairman.

Mr. JONES of Tennessee. Mr. Kleckner, do you have something else?

Mr. KLECKNER. Mr. Chairman, one quick comment.

It would seem to me that we focus so much attention on the Farm Credit System area, I don't know what committee it comes before, but before too long, Mr. Naylor, Mr. Duncan, and a third member of that new FCA will be up for approval. It seems to me that some of the questions and concerns that you have, might properly be addressed to them as to how they would respond, because they are going to be, perhaps, the key three people in the Farm Credit System.

Mr. JONES of Tennessee. For your information, Mr. Kleckner, that will be handled by the other body.

Mr. Webb Franklin, do you have any questions.

Mr. FRANKLIN. No questions.

Mr. JONES of Tennessee. Thank you very much, gentlemen, for appearing, for four good statements; we appreciate them more than you know.

Panel 3, Mr. Paul Sacia, assistant director of legislative affairs, National Farmers Union here in Washington; Mr. Cecil Huff, cochair, National Farmers Fair Credit Committee, Ava, MO; Dr. Barry M. Casper, Crisis in Agriculture Project, Carleton College, Northfield, MN; Dr. Robert Jolly, professor of economics, Iowa State University, Ames, IA; and Ms. Maureen Steinbruner, executive vice president, Center for National Policy, Washington, DC.

The Chair will follow the names as they appear on panel 3. Mr. Sacia, assistant director, legislative affairs, National Farmers Union, you are first; you may proceed.

STATEMENT OF PAUL R. SACIA, ASSISTANT DIRECTOR, LEGISLATIVE SERVICES, NATIONAL FARMERS UNION

Mr. SACIA. Thank you, Mr. Chairman. As always we appreciate your accommodation and access as far as hearing from farmers these days, during these trying times.

Today this subcommittee has heard from many organizations, all in some way verifying the magnitude of the farm crisis. We will focus on that aspect, and we would also like to discuss what can be expected from us as a general farm organization during these trying times.

First, the National Farmers Union president, Cy Carpenter has made it clear that this organization will continue to tell of the dispair and anger of our farmers and ranchers, no matter how negative that might sound to some ears. We are absolutely beholding to our members to tell their story, and that story is getting uglier every day.

To those that claim that anyone who sharply criticizes U.S. farm policy at this time is politically motivated, we would simply respond that anyone who remains silent as they witness the administration of the most failed farm policy in American history, would be the first to have their motivations questioned for letting politics stand in the way of reason.

Mr. Chairman, our organization has never deviated from the belief that supply management, fair prices and international cooperation in trade are essential for workable agricultural policy; and several decades of stable, prosperous agriculture back up our conviction.

This hearing today is important because we can begin to respond in kind to the severity of the farm depression. We need to get the wheels of agricultural credit turning again in order to buy time for farmers as they wait for farm income to be restored. A quick telephone sampling of our States only adds to the established fact that chaos now reigns in much of rural America as farmers battle for credit to stay afloat 1 more year.

And I will submit their assessments for the record, and just say that such appraisals that they have submitted simply underscore some of the contributing factors to the general mood of dispair and frustration in rural America. The 3 months after the farm bill was passed we must ask where are the experts and economists to be found who believe that the principal objectives of this farm bill are being met now or ever will be met.

These farm families deserve to have some hope, Mr. Chairman. If ever there was a time for Congress and the administration to be bold, this is it. The Farmers Union is not asking for any band-aid approaches for this wound, so self-inflicted by Federal policy. A tourniquet needs to be applied immediately in the form of substantial credit legislation to stop the hemorrhaging and then we need to turn our sights on the prime issue of increasing farm income.

We commend Representatives Bedell and Daschle and the other cosponsors for their bill, H.R. 4267, the Emergency Farm Income and Credit Bill of 1986. We believe it is bold legislation which address both the emergency credit and farm income side of the equation.

We support the concept of providing a 90-percent Farmers Home Administration loan guarantee to lenders for the purpose of restructuring existing agricultural loans. We especially like the idea that the interest buy-down provisions of this bill will encourage lenders to write off additional unproductive debt beyond the minimum 10 percent.

While we enthusiastically endorse H.R. 4267, we would like to make the credit portion more far reaching; that is why our organization is also supportive of another credit package, the fair credit plan which is complementary to H.R. 4267.

This is a fairly new proposal, and I would like to just touch on some of the general aspects and some of the other people on this panel will deal with some of the details.

The reason we believe this legislation to be essential rests upon one frightening finding by the Department of Agriculture. As of January 1, 1985, the Department showed that one-half of the family-sized commercial farms experiencing financial stress had no income at all left for loan payments after paying farm operating and family living expenses.

Of course, with another 15 months passing, things have only worsened. We are concerned that various debt restructuring proposals, no matter how well intentioned, are inadequate in assisting farmers whose debt-to-asset ratio exceed the 70-percent level.

As in the Bedell-Daschle bill, attention would be directed to the underlying cause of the farm crisis, that being depressed income.

The first year's Government outlay would be approximately $1.7 billion, given current commodity prices.

If for instance, however, prices were to be set at more reasonable rates of around $5 per bushel for wheat, and $3.60 for corn, with accompanying production set-aside programs, the program cost would be reduced immediately by about 60 percent. With what is at stake this is not an unreasonable investment.

Under the fair credit plan, lenders would remain solvent; money would be lost in writing down the loans, but they stand to lose much more under current circumstances.

Family farmers in trouble would remain in business. Some would lose land in partial repayment of their debt, but would still be operating a viable farm, with manageable loan payments.

Finally, thousands of farm foreclosures would be prevented, thereby stabilizing land and equipment markets, slowing the downward spiral of prices as reducing the assets of farmers.

We are highly supportive of the mediation provisions of this bill. The relationship between farmer and lender is becoming so combustible we need a mechanism of this kind.

A deferred payback provisions of this bill are key. the farmer's payback to the Government of money advanced during the emergency would be deferred until farm income rose to the point that he could afford to begin repayment. Again, this way, outlays would be directly linked to commodity prices and other determinants of farm income.

Mr. Chairman, it is safe to say that we all make mistakes. By the nature of the business, farmers take chances and make mistakes and then must swallow their pride and make the necessary adjustments in their operations to stay viable

A mistake has been made in agricultural policy in this Nation. Evidence is irrefutable; and we can't afford to play this scenario out just for the sake of pride, because it is economically and emotionally destroying thousands of families, as well as eating away at the infrastructures of our rural communities.

We are urging America's farmers to fight back. We will do all we can as an organization for them to keep their farms.

We feel it is so important to turn their despair into some hope, but ultimately that hope must come from you. We encourage you to support H.R. 4267, and the fair credit plan.

We want to thank you for your time and consideration. Thank you.

[The prepared statement of Mr. Sacia appears at the conclusion of the hearing.]

Mr. JONES of Tennessee. Thank you very much, Mr. Sacia, for your statement.

The next witness is Mr. Cecil Huff, cochair of the National Farmers Fair Credit Committee, Ava, MO.

Mr. Huff.

STATEMENT OF CECIL W. HUFF, COCHAIR, NATIONAL FARMERS FAIR CREDIT COMMITTEE, NATIONAL SAVE THE FAMILY FARM COALITION

Mr. HUFF. Thank you, Mr. Chairman, and members of the subcommittee. I am a dairy farmer from Ava, MO; and active in several other organizations besides being cochair of the farmers fair credit committee, which is a committee under the National Save the Family Farm Coalition.

Our committee is a coalition of over 70 grassroots farm and rural organizations from 18 States, who have come together to find an equitable solution to the debt crisis facing family farmers.

The committee has identified three principles that we believe must be part of a plan that adequately addresses the farm debt crisis. Those are:

One, that any bailout be targeted to family farms and that the central focus be to save as many farmers from losing their farms as possible.

Two, that it works to keep both lenders and farmers solvent, but the help to lenders would come first through the farmer being helped.

Three, that it be linked in some way to the ultimate goal of raising farm commodity prices to a fair and livable level.

The National Farmers Fair Credit Committee has spent the last several months writing our own plan that adheres to the principles that I have just laid out. Our plan, now in bill form, is called the fair credit plan, which I would like to talk about today.

Before I speak specifically about our bill, I need to impress upon the members of the subcommittee the seriousness of the crisis today, and the need for immediate and adequate action.

In my State, and in the 17 other States that we have groups in, the story is the same, our farm crisis hotlines are ringing constantly off the hook with desperate farmers both young and old, asking and calling for help. The stress is mounting as these families struggle to put a crop in, while carrying huge and growing debt loads, and trying to keep their children fed and clothed.

It isn't just a few poor managers being squeezed out in a move toward greater efficiency. We are losing our brightest and best educated farmers, the ones that follow the University of Missouri extension line and advocated to incur the debt to buy the modern technology to increase production. We are also losing our older farmers through foreclosures and involuntary conveyance of property, these farmers are losing a life time of labor and their life savings with the stroke of a pen.

These older farmers where considered as moral pillars in society and oftentimes, men of wisdom. Now they are faced with becoming society's new poor.

I won't dwell on the statistics, but I would like to confer with Paul Sacia's statement of the agricultural statistics that one-half of our commercial-sized family farm do not have any money for debt repayment after they pay farm operating and family living expense. The other bills that have been proposed are grossly inadequate.

I was a little heartened to see Dean Kleckner's proposal that he called a two-tiered debt system, we called it debt tabling 2 years ago in the grassroot movement. That is not a new concept to us. I am a little heartened that Farm Bureau is catching up with some of the problems that are facing the farmers.

This alarming fact that half of these farmers have no money, has a significant impact on the effectiveness of most of the proposals for emergency debt relief that are being discussed. There are several proposals being discussed today that propose restructuring debt with the combination of lender forgiveness, Government assistance to write-down loan principals and interest rates. But all have the common flaw that they will not save a substantial portion of our commercial-sized family farmers.

With each of these proposals there is an underlying assumption that we just cannot just can't save everyone. There are just some farmers that will have to go under, that is their assumption. We do not concur with that, there is too many farmers lost in the land today already without adding more to it.

In light of the financial conditions over half the family farmers in trouble however, these some farmers that they indicated that can't be saved turns out to be a substantial number and actually might let the food producing ability of the American agriculture fall out of the family farms control.

These plans simply do not offer an adequate relief if the goal is to save our family farm type of agriculture, what is left of it.

This is why we are proposing the fair credit plan; it is a comprehensive debt relief plan that really speaks directly to the issue of saving most of our family farmers in trouble.

The fair credit plan would be federally funded; State-administered emergency response to the financial crisis in agriculture. The major features of our bill that it applies to all agriculture lenders, and this includes individuals. And in none of the proposals I have heard here today did any of the proposals address owner-financed property.

And the statistics that I am looking at say that owner-financed property in this country is equal to what the insurance companies are financing, will run into the midteens of the total farm debt or financed by past farmers and individuals. And our bill intends to give those people the same options that the State, that the Farm Credit System has in their bill, or proposed write-down in other bills.

I noticed I am running short of time. I do want to submit this for the record.

The one thing I want to point out to this subcommittee is I think this farm crisis that started 5 years ago, is now a rural crisis affecting so many other businesses, school districts, county courts. The thing to me is that this is worse than any natural disaster that has every hit anywhere in the United States of America. And the reason that it is worse is that it cannot be accepted by the people in the country. We can accept acts of God, but we cannot accept acts of man.

This farm crisis is man-made; and this farm crisis can be turned around when we as individuals, and we as groups decide that we want to turn it around. And it won't be turned around until we make that decision.

That that is why we as rural people cannot accept this crisis that is happening, because it can be corrected.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Huff appears at the conclusion of the hearing.]

Mr. JONES of Tennessee. Thank you very much, Mr. Huff, we appreciate your being here.

The next witness is Dr. Barry Casper, Crisis in Agriculture Project, Carleton College, Northfield, MN.

STATEMENT OF BARRY M. CASPER, DIRECTOR, CRISIS IN AGRICULTURE PROJECT, PROGRAM IN SCIENCE, TECHNOLOGY AND PUBLIC POLICY, CARLETON COLLEGE, NORTHFIELD, MN

Mr. CASPER. Mr. Chairman, members of the subcommittee , I am pleased to have the opportunity to testify before you today on behalf of the fair credit plan, and to contrast it with other emergency agricultural credit proposals you will be considering.

I would like to submit for the record, both my written statement and a short discussion of how the fair credit plan would be implemented, with your permission.

Mr. JONES of Tennessee. Without objection it will be make a part of the record.

Mr. CASPER. [Displays charts.] Most of the proposed emergency credit plans have one element in common, as shown in a chart I would like to show you.

What happens in almost all the plans that we are hearing about now is that if you take the farmers debt, which might be a couple of thousands—$100,000—up at the top line up there—what almost every one is saying is that the first thing that should happen is that the lender should write down that debt somewhat. And then many people are advocating that that loss be written off over several years in order to make it more tolerable to the lenders. We certainly would accept that policy.

But after the write down there frequently remains a gap in the written down debt. That is what I have shown there. There is another line down there which is the debt that the farmer can cash flow.

And after the lender has written down the debt somewhat you have still got this gap, that is where the Federal Government comes in, and that is where the various proposals that you are going to be hearing about, differ significantly. They have very different gap philosophies resulting in very different outcomes for the farmer in trouble.

To aid you in assessing the desirability of the emergency plans you will be hearing about today and in the coming weeks, I want to propose a critical test. You should ask the proponents of each plan to answer clearly and directly the following questions:

How many of the farmers in trouble today will be saved by the emergency credit plan you propose? How many of those farmers who are in trouble today will lose their farms?

The fair credit plan provides a framework for analyzing for a given government expenditure what the answers to those questions will be.

I want to urge you not to be satisfied with vague replies like: Of course, some of the farmers in trouble will not make it.

We have already heard that today from one witness. What you will find if you will probe more deeply is that some of the proposals receiving the most attention so far would amount to a triage policy for the American family farm. The sum of the farmers who won't make it under the terms of these proposals would be a third or more of the commercial family farms.

Of course, it requires careful analyses to answer in detail the question I propose. But some general effects are easy to spot. Statistics compiled by the U.S. Department of Agriculture on the financial condition of farmers makes clear why the alternative proposals are adequate and the fair credit plan is needed. You have this one fact stated, but I want to underline it.

As of January 1, 1985, the latest figures released there was a striking fact about the family-sized commercial farms experiencing financial stress. If what we are doing is not trying to take a look at those farmers who are in trouble, say, those who have a debt to asset ratio with their lenders, so those that a debt to asset ratio greater than 40 percent say.

What the USDA statistics show is that after paying farm operating and family living, approximately one-half of these farm families had no income at all left for debt service. That was 1 year ago, and in the meantime commodity prices have declined even further.

So, for many of the family farmers in trouble today, the cash-flow situation is not really like the one that is shown in the first chart, which is kind of the way people seem to make—is implicit in some of the descriptions that you will hear from proponents of other plans.

Rather, it is like that shown here in the second chart. For half the family-sized commercial farmers in trouble today, the debt the farmer can cash-flow is around zero, so the gap is enormous. What this demonstrates directly is that proposals such as that of Minnesota Senator Boschwitz, or Oklahoma Senator Nickles, or Iowa State economist Neil Harl that purport to those tens of thousands of family farmers in trouble by writing down their debts and/or their interest rates is not going to be enough.

The great majority of these farmers will still be unable to meet their loan obligations. So these debt-restructuring proposals, no matter how good they sound, or no matter how well-intentioned their proponents, are inadequate to cope with the seriousness of the emergency.

Before you act—don't take my word for it—before you act ask the Congressional Budget Office to analyze each of the proposals and then report back its estimate of how many farmers will be saved and how many will lose their land among those farmers that are in trouble for every plan that you are hearing. For most of the family farmers in trouble to survive this crisis a temporary Government loan of additional money to make up the difference between what the farmers can afford to pay at today's commodity prices and the written down debt payments that will be required. And that is the essence of the fair credit plan.

Let me just add by commenting on one particular proposal that I think deserves particular mention, and that is the Bedell-Daschle bill. As I understand it that proposal and the fair credit plan have the same gap philosophy. The gap that remains between the debt the farm can cash-flow and the written down debt must ultimately be closed by an increased in farm income if our family farms are to survive.

If farm commodity prices go up significantly this year, as in the price part of the Bedell-Daschle bill, then the credit part of that bill in which lenders write down farmer's debts to the level that they can cash-flow makes, sense. With higher commodity prices the write down to farmers' debts cash-flow levels would be tolerable to lenders.

But if commodity prices do not go up this year, a lender write down to the level where many farmers can cash-flow is exemplified by that huge gap on that last graph, now would impose an unacceptably heavy burden on the lenders.

The fair credit plan would limit the lender write downs to acceptable amounts, whether commodity prices go up this year or not. At the same time, it would keep farmers on the land through a loan to fill the gap temporarily, until commodity prices go up.

In summary, then, the fair credit plan would help almost all the family farmers and the agricultural lenders in trouble today. In contrast most of the alternative emergency credit bills are either blatently unfair or woefully inadequate. Some are targeted to rescue one of the two groups in trouble, the lenders, but sacrifice the other group in trouble, the family farmers.

Even those aimed at helping farmers would result in a substantial fraction of the family farmers in trouble today losing their farms. While the Bedell-Daschle bill shares the fair credit plan's gap philosophy, unlike the fair credit plan, it cannot stand alone as emergency credit legislation if its price provisions fail to pass this year.

Thank you.

[The prepared statement of Mr. Casper appears at the conclusion of the hearing.]

Mr. JONES of Tennessee. Thank you very much, Dr. Casper.

Our next witness is Dr. Robert Jolly, professor of economics, Iowa State University, Ames, IA.

STATEMENT OF ROBERT W. JOLLY, PROFESSOR OF ECONOMICS, IOWA STATE UNIVERSITY

Mr. JOLLY. I would like to make just a few comments so that we can continue this hearing on schedule. First of all, we have been faced with financial difficulties in Iowa and in the United States for the past 5 years, since 1980. Only in the last couple of years has this problem been brought to public attention. It is even in a shorter time frame that we have had reliable national level information on the incidence of the problem and its intensity.

Certainly, as other witnesses have described, we are confronted with a national issue. It does not impact farmers uniformly. We have heard comments about the three aspects of the three subpopulations within the farm groups, where one group would be experiencing some financial progress; a middle group that was basically holding its own; and then the third of the farmers that are experiencing significant financial stress and the concomitant emotional stress that goes along with that.

One of the problems that we have in trying to understand the types of policy response that might be appropriate for this problem is that the magnitude of change that is likely to occur is sizable, but the pace with which it occurs is relentless but not particularly dramatic.

We have just completed in Iowa a financing status survey. This is an updated telephone survey of Iowa farm operators. In January we found that about 30 percent of the operators had credit arranged, 30 percent did not, and 40 percent said they didn't borrow any operating money. The demographics of that group that did not borrow operating money, as you might expect, these are the older farmers, running smaller operations and nearing retirement.

In the past month and a half, we have seen some progress in meeting their financing needs. Fifteen percent now remain without credit. If we use their expectations of whether they are going to be extended credit or not, this would suggest only 5 percent would not receive credit for the coming year. Two years ago, 5 percent would have created a real sense of alarm. At the moment, it seems to be a statistic that reassures individuals that the crisis is manageable. Five percent of Iowa's 113,000 farmers is a significant portion. I think we need to understand their needs more completely.

It is unlikely that we are going to find thousands and thousands of farmers in any one period of time out on the section line with their suitcases. What we will experience is a grinding process that extends over a 5- to 6-year period. When we're through with it, we will wonder where our farmers have gone and why rural America is such a distinctly different place than it was at the onset of the crisis.

We have recently completed a study, and I would like to share some statistics with you. If you look at the individual farm firm, there are a series of stages that it goes through as it attempts to deal with financial stress. The initial response is to try to improve productivity or cut costs. If that isn't corrective, then the firm will move into a stage where it attempts to restructure debt, extend repayment terms. If that's not successful, then the firm will move into a restructuring of assets in which assets are liquidated, debts are brought down. If that's unsuccessful, then the firm will fail.

Those stages are not unique to agriculture. All financially stressed businesses will go through that general process. But whereas it makes sense in the micro sense, the firm level, to think about a firm moving through those stages, it very often becomes unworkable when an entire industry is required to move through that process in a relatively short period of time. Our estimates would suggest up to 20 percent of the assets held by commercial farmers may be liquidated over this restructuring period, however long it lasts, 2 to 5 years.

The normal volume for these markets is 2 to 4 percent of the asset base. Up to 25 percent of the farm operators could be liquidated, and debt writeoffs could run in the range of $10 to $15 billion. So, as we are looking at policy responses, we need to bear in mind that this adjustment that we face in agriculture easily could exceed the capacity of our institutions, markets and individuals to make this transition. But it's a difficult problem for the political process to face because it is slow. It is deliberate. And it fundamentally will alter the face of American agriculture in the future.

As a consequence, many of these programs that we see proposed attempt in one way or another to buy time, to facilitate the restructuring process, to ameliorate some of the side effects. The proposals that we have or programs that we have available, however, are often written with such restrictive rules such as the debt adjustment program or the interest rate subsidy program that the Farmers Home Administration uses. It is extremely hard to qualify people that could use this bridging assistance, this assistance as they attempt to restructure. As a consequence, the only people that can qualify, if anyone can, are those that may be able to survive without the program.

So, we have in fact an unusual situation in this regard, where we create assistance programs that in fact provide very little assistance because of very restrictive qualification rules.

I think the programs and policies need to be valuated on their ability to help farmers and the institutions that serve the farm community adjust to very different economic conditions and, along with that, attempt to look at income, support mechanisms, support programs for farmers that would target more of the income support into the hands of individuals that are experiencing stress.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Jolly appears at the conclusion of the hearing.]

Mr. JONES of Tennessee. Thank you very much, Dr. Jolly, for your statement.

The last witness on this panel is Ms. Maureen Steinbruner, executive vice president, Center for National Policy, in Washington.

Ms. Steinbruner, we are pleased to have you. You may proceed.

STATEMENT OF MAUREEN S. STEINBRUNER, EXECUTIVE VICE PRESIDENT, CENTER FOR NATIONAL POLICY

Ms. STEINBRUNER. On behalf of the Center for National Policy's chairman, Edmund S. Muskie, and the members of our board of directors, I would like to thank the chairman and members of this subcommittee for the opportunity to be here today.

The Center for National Policy is a public policy organization based here in Washington. Our purpose is to develop constructive approaches to national problems and to foster better ways of achieving national goals.

For the past year, as part of a longer term project on food and agriculture policy, the center has been among the many groups examining the farm credit problem and addressing the question of whether there might be a reasonable way for the Federal Government to assist farmer-borrowers through the present debt crisis.

We recognize fully that reducing the Federal deficit is a primary objective at this time. Lowering the deficit should, in principle, benefit the farm sector as well as other sectors of the American economy.

With this in mind, we have tried to identify that segment of all commercial farms having problems with debt specifically, so that any resources committed to debt relief would be used effectively. As you know, research conducted by a number of analysts, including Emmanuel Melichar, Neil Harl, Bob Jolly, who is here today, their academic colleagues, and others at USDA and in lending institutions, has helped to narrow the focus significantly by sorting out different degrees of indebtedness, or debt-to-asset ratios. More recently, using new data from USDA's spring 1985 farm costs and returns survey, the focus has expanded to include the issue of debt service capacity.

After consulting with a number of these specialists, we decided that it would be useful for our purposes to carry this line of analysis one step further.

Thanks to recent reworking of the data by USDA, this further step was possible, and we are now able to estimate with some degree of confidence that about 128,000 commercial farms are in a category which we believe should be considered the primary target group for any debt assistance program. About 66,000 other farms are close enough to being in this category that they could well be included. That would be a total of about 194,000 farms, and this is the number on which we have concentrated.

Let me explain briefly how we arrived at this number in sorting out the question of overall profitability from the specific problem of debt.

We first divided farm operations into three size categories. Based on gross sales in 1984, we counted as large those farms with over $250,000 in gross sales. We counted as medium those farms with between $40,000 and $250,000 in gross sales, and classified as noncommercial those farms with sales less than $40,000.

Second, for the purposes of this study, we looked at what we call farm operating margins, essentially a ratio of net to gross income, intended to reflect the relative degree of profitability of farm operations.

We constructed two different operating margins and compared them. The first margin was arrived at by accounting for direct cash operating expenses except for debt service. The second was arrived at by accounting for operating expenses including debt service.

For the large and medium farms, we then sorted farms by operating margins, dividing them into the categories of negative margin, or net loss, medium margin and high margin. I should note that our analysis suggests that there are a number of farms that are operating with extremely favorable margins, even under current circumstances, and even after debt service. I think Congressman Evans made a comment about 70 cents on the dollar being returned to some of his farmers, and they are in that category.

But about 15.5 percent of the large farms and 16.4 percent of the medium farms report income and expenses which result in a calculation of negative margins before debt service is even considered. That is a little more than 103,000 farms, by these estimates.

After debt service, the proportions with negative margins roughly double, to 35.2 percent of large farms, and 36.7 percent of medium farms. This is approximately 128,000 farms in apparently serious trouble as a result of debt service.

How do these data relate to the information available on debt-to-asset ratios? If we look at the medium farms, we see that the average debt-to-asset ratio for all farms in our medium category is 0.24 percent. That increases to an average of 0.36 percent for just those farms with negative margins.

That's not right; it's redundant. It's 0.24, or 24 percent.

As these data confirm, most farms have relatively small debts, although the averages are high by historic standards.

Also, we find that a not-insignificant segment of the farm sector is only marginally profitable now, or is not profitable at all, without regard to debt service costs, and in some cases at relatively low debt levels.

We believe that these circumstances complicate the credit problem immensely. Programs to deal with credit will not eliminate underlying problems of profitability. And, any program not carefully targeted will benefit many farm operations that are not in need of such assistance for survival.

Obviously, both the sector's income problems and its financial problems are centered in the current depressed condition of the market. What is the likelihood that this condition will change significantly over the next year or two? As you know, most analysts do not believe that aggregate income to the sector will improve significantly over this period. It is generally felt that there probably will be some relief on the expense side, due to declines in interest rates and energy prices. But overall supply and demand conditions are not expected to generate much improvement in farm income, if any, in the near term. And the degree to which interest relief can be granted to those borrowers most in need of it is not clear, given the lenders' need to build loan loss reserves. You spent a lot of time on that subject this morning.

Therefore, the pressure on borrowers, lenders and real estate values seems very likely to continue, particularly in certain regions of the country.

As we note in our study, there is always an argument to be made in cases like this that the Government should take no particular action, and that adjustment should be allowed to occur unimpeded.

We do believe that there are a number of reasons why some action should be taken to relieve the debt stress on the system; but, even if these reasons are not persuasive in current circumstances, it is possible that the stress will get worse before it gets better. Others who are testifying today can speak to this point directly, and I will not attempt to offer a prediction. But I would like to suggest that, if the situation does deteriorate much further, problems could be harder to contain, and there is some risk that options now available will be foreclosed.

In our study we have looked at the range of measures which different individuals and organizations have proposed over the course of the past year, and have tried to assess the costs and feasibility of such measures, using the target group that we have identified.

I will skip over some of this, because you have heard about it already this morning.

A number of ideas introduced into the debate over this issue since the beginning of this year have begun to address the problem of focusing on the borrowers.

In our study, we concluded, as others have, that an assistance program combining a number of the elements suggested in such proposals might in fact be effective.

We examined the range of debt service relief that might be obtained through interest decreases, through stretchout of amortization periods, and through writedown of principal.

We made an effort in this examination to look at some realistic individual debt service examples in order to relate the degree of relief which might be provided to the amount of relief which would be effective. This is difficult to do and requires that a number of assumptions be made about real farm operations, their cash flow situation, and the range of debt they might be carrying. But we belief that this analysis, in spite of its limitations, does contribute to a realistic picture of the possibilities for assistance.

Having done this, we decided that in fact some amount of Government aid could make a significant contribution to the viability of debt restructuring efforts.

We have a specific proposal for such assistance, which we believe could be designed to limit the Government's costs to a minimum in relation to the alternatives, at least the effective alternatives. It would involve lender costs, and it would require borrowers to put some equity on the line. Not all borrowers would be able to take advantage of such a program, and we assume that not all lenders would be willing and able to participate to the extent needed for maximum coverage. But the proposal has the advantage of being designed so that the tradeoff between participation and cost is minimized.

We are in the process of refining our cost estimates right now and will have them available on Friday. We offer this proposal for discussion, and it may well be that it could be useful in relation to other proposals now under consideration by this subcommittee.

I would be glad to try to answer any questions. We will submit the full proposal.

Thank you. I am sorry I ran over.

[The prepared statement of Ms. Steinbruner appears at the conclusion of the hearing.]

Mr. **Jones** of Tennessee. Thank you very much, Ms. Steinbruner, for your statement.

That does conclude all the witnesses on panel three. I would advise the subcommittee that we are running behind. If there is anything you can do to help expedite the situation, it will be appreciated by the chairman.

We have two Members of Congress who are present to be heard as soon as possible.

Mr. Coleman, you are recognized.

Mr. **Coleman**. I will certainly join you in those efforts to try to keep this back on track.

I would ask all of you to submit to us, if possible, cost estimates of your program, as Ms. Steinbruner has indicated she will do. It is very helpful to us. We have to consider the ramifications of the budget as we deal with this in order to insure passage, if we were to get something out of this committee. So, we can't just continue in the dark on numbers. And I would appreciate all of you to do that if you can.

Mr. **Jones** of Tennessee. Thank you, Mr. Coleman.

Mr. Tallon, do you have questions?

Mr. **Tallon**. No, Mr. Chairman.

Mr. **Jones** of Tennessee. Mr. Gunderson?

Mr. **Gunderson**. No questions.

Mr. **Jones** of Tennessee. Mr. Thomas?

Mr. **Thomas**. No questions.

Mr. **Jones** of Tennessee. Mr. Franklin?

Mr. **Franklin**. I have one, Mr. Chairman.

To give you a factual example of a particular farmer in Mississippi, he owns 250 acres of land. He rents 750 acres of land. He plants half cotton and half soybeans. By his own estimates, his equipment is valued at $150,000 and his home $120,000 and the 250 acres at $300,000—a total asset value of $570,000. He owes the Farmers Home Administration $1.6 million. He has had seven loans for the seven past crop years. He has never in one of those 7 years repaid fully the crop loan.

Under the debt restructure plan that you are suggesting, all of you together, would this farmer be qualified to be refinanced and kept viable in business? I would like to start with Dr. Casper and go down the line and have you to answer that question.

Mr. **Casper**. Those are a lot of numbers coming pretty fast.

Mr. **Franklin**. You've got total assets of $570,000 by his own figures, and he owes $1.6 million to the Farmers Home Administration.

Mr. **Casper**. Right. I think in the kind of process that we described, what would happen is a mediation kind of proceeding where, with the kind of numbers you described there, in the fair credit plan, I should—what wasn't mentioned is, there's a cap on the annual loan that can go to an individual farmer, in order to keep it to small family-sized farmers and——

Mr. **Franklin**. My question——

Mr. **Casper**. Let me finish the answer please——

Mr. **Franklin**. If you were the dictator, would you refinance or restructure this——

Mr. **Casper**. I want to tell you that, under the fair credit plan provisions, which we have submitted, with a $30,000 cap on the annual loan the farmer can receive, that person would not be able to make it——

Mr. **Franklin**. So, you would not—you would agree that the committee should not come up with a plan that would allow this fellow to restructure and continue in business under that situation? You'll agree with that?

Mr. **Casper**. I would say that, with a $30,000 cap on the loan, and with very little land that he could transfer, it would be difficult to restructure the loan.

Mr. **Franklin**. Mr. Sacia.

Mr. **Sacia**. I agree with that. Under these circumstances he just wouldn't be able to survive that mediation process.

Mr. **Franklin**. Dr. Jolly.

Mr. **Jolly**. Now, if you're looking at the proposals that you have in front of you or the Farmers Home Program that you have, there's no way on Earth you're going to qualify that individual.

Mr. **Franklin**. Mr. Huff.

Mr. **Huff**. I would think that in our plan he would at least have the chance to qualify. We would run him through. He wouldn't be eligible for the full $30,000; we would ask that he sell off part of his assets, that the debt be written down. My best guess is that he wouldn't survive the system.

Mr. **Franklin**. You would try to keep him in business?

Mr. **Huff**. I would advise him personally to submit under our plan, yes, and with the understanding he would lose a portion of his assets.

Mr. **Franklin**. Ms. Steinbruner.

Ms. **Steinbruner**. In my understanding, this person has a debt-to-asset ratio of 200 percent, and his land is valued at $4,000 an acre. Is that the way that works out?

Mr. **Franklin**. No.

Ms. **Steinbruner**. He's got 250 acres that he owns, is that right, and a million——

Mr. **Franklin**. I think it's $1,200 an acre.

Ms. **Steinbruner**. And $1 million in debt?

Mr. **Franklin**. $1.6 million.

Ms. **Steinbruner**. He only owns 250 acres, though, is that correct?

Mr. **Franklin**. And has the right to farm 750 more.

Ms. **Steinbruner**. OK, but his collateral is just that base, plus some equipment, and we don't know what that's worth.

Mr. **Franklin**. He estimates the value at $150,000. Total assets, his value, is $570,000.

Ms. **Steinbruner**. Right, which is half of what he has outstanding. It doesn't seem to me that you can write down that much, take it out. It's pretty far gone.

Mr. **Franklin**. Thank you.

Thank you, Mr. Chairman.

Mr. **Jones** of Tennessee. Thank you, Mr. Franklin.

Does any other member of the subcommittee have a question?

Mr. Evans.

Mr. **Evans** of Iowa. Thank you, Mr. Chairman.

I missed most of the questions. Perhaps if I am duplicating something, you will stop me.

I noticed that Dr. Jolly talked about perhaps 5 percent of Iowa farmers would not receive credit. I think that, based on Dr. Casper's estimates and some others, the percentage that would not receive credit was much higher than that. That leads me to the point that I believe to be true. The geographical distribution of this third, that roughly one-third that is in very serious trouble, is not uniform across the United States. There are some areas such as much of Iowa, where agriculture is inherently more economically efficient by virtue of a far lower risk of crop failure, for example, better soil, better climate, et cetera, et cetera.

My question to Dr. Casper is, How would you, or do you think we should accommodate that problem? In parts of the United States—

northern Minnesota would perhaps be a good example—there are very high risks associated with farming, and therefore a lot of that agriculture is economically very inefficient. You have got the areas of the Sand Hills where you have expensive irrigation water to pump and compared to parts of Iowa, that agriculture is inherently inefficient. You've got very rough, highly erodable lands. You've got lands on the river bottoms that are subject to floods.

The direction that we are going, for better or for worse, is to shrink agriculture into the more productive geographical areas, it seems to me, whether one agrees with that or not.

Would you try to preserve under your system the economically inefficient geographical areas, or would you allow that kind of shrinkage to persist?

Mr. CASPER. Who wants to come out in favor in inefficiency. Thanks.

Mr. EVANS of Iowa. This, of course, is an extremely difficult political question.

Mr. CASPER. I think the kinds of issues that you are raising really about geographical differences are really quite important and really have to be considered in developing debt restructuring legislation.

Another thing that is different and which Iowa doesn't come out so well is that the assets have declined much more seriously in Iowa and in the upper Midwest, for example, than in many other portions of the country. In some sense the farmers have taken much more of a loss in that area. So, in a debt restructuring plan in which you want to think about sharing those losses, it may be that the lenders would want to take more of a loss in that area than in some other areas like Texas, where, for instance, the land has appreciated.

I think, as we begin to refine the kind of proposal that we made today, that geographical circumstances do have to be taken into account.

Mr. EVANS of Iowa. Well, I do, too. I don't want to belabor the point today, but it is a very difficult question. I don't know how to approach it.

Mr. THOMAS. Would the gentleman from Iowa yield?

Mr. EVANS of Iowa. Yes.

Mr. THOMAS. This is directly in line with some of my concerns. I would just like to add this briefly if I can.

In our part of the country, in the Southeastern United States, I think it is pretty well documented that we have the bulk of the prime land that is in reserve and not in production at this time. We have got adequate underground water, where many other parts of the country, the water supply is being diminished, depleted. We have long growing seasons. The disturbing thing to me is, where we certainly might can point to other parts of the country at this time being better parts of the country to hopefully survive, that we are going to decide who is to survive and not. But if we allow our agricultural structure in that part of the country, the one part of the country where it can be meaningfully increased in the coming years, if we need it, that land is going to go into some other use, pine tree production, for example, where it is lost most often to industrial ownership and institutional ownership.

This is an issue that concerns me as well. I think that what this committee has to realize is not just for the moment in the short time, is it more profitable to select parts of the country where we can be of more help, but we've got to also account very realistically for what our future need for land is going to be and set our goals accordingly.

Thank you for letting me have that remark.

Mr. EVANS of Iowa. I yield back my time, Mr. Chairman.

Mr. JONES of Tennessee. Thank you very much, Mr. Evans and Mr. Thomas.

Thank you very much, panel. We appreciate your being here.

We will take the liberty, without objection, to contact you for any future information we might want from you. We appreciate your testimony.

We have two members of the U.S. House of Representatives who are present to be heard on this subject today. The Honorable Byron L. Dorgan, a Member of Congress from the State of North Dakota, is here. The Honorable Jim Lightfoot is a Member of Congress from the State of Iowa. If you two gentlemen will be seated at the witness table, we will be glad to hear from you.

Mr. Dorgan, inasmuch as you have been around here for a little longer than Mr. Lightfoot, you will be heard first.

STATEMENT OF HON. BYRON L. DORGAN, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NORTH DAKOTA

Mr. DORGAN. Thank you very much, Mr. Chairman.

First let me thank the subcommittee for holding these hearings. They are very timely and important to farmers from all over the Midwest and especially the farmers I represent in North Dakota.

Let me depart just for a moment and offer a complete text of my comments for the record and would hope, without objection, they would be made a part of the record, Mr. Chairman.

Mr. JONES of Tennessee. Without objection, they will be made a part of the record.

Mr. DORGAN. I would like to briefly tell you that I just received a call about a half hour ago from a fellow named Albert Markle. His call buttresses the concern of the farmers that I have heard from over the past several weeks in North Dakota. Albert is sitting in St. Thomas, ND, this afternoon on his farm. He would like to be out in the field. He doesn't have an operating loan. He would like to have the petroleum, seed, and the fertilizer to get out and get started farming.

He has been to the Farmers Home Administration. He submitted a loan application. That loan application has been approved. But there's no money. In North Dakota, as in many States at this point, we have $11.6 million in approved loan applications that are sitting at the State Farmers Home offices in Bismarck. But there's no money. So, we have folks like Albert Markle, who today would like very much to be in the field but don't have the operating loan because, even though their loan has been approved, the State Farmers Home office does not have the money to fund it.

I would like to ask the subcommittee and you, Mr. Chairman, to help as much as you can to persuade the Farmers Home Administration to move this money out that exists. And there does exist now about $500 million in loan funds that have been transferred, that are available for operating loans through the Farmers Home Administration. I would encourage you to do what you can with this subcommittee to light a little fire under the right people to move that money out now.

Operating loans or spring planting loans don't do any good in July in North Dakota. Now is the time that we need them.

I have been on the phone to the Farmers Home Administration. I don't accuse them of ill will. I do say that the current approach does produce, in my judgment, a bottleneck of funds that are available.

I am not asking for appropriations above that which has already been promised as a result of congressional action and as a result of a transfer in the Farmers Home Administration. But you can imagine, I am sure, all of you who sit on this committee, what it would be like if you were out there this afternoon, wanting desperately to get into the field, knowing that you filed a loan application a month and a half ago. It was approved. You expected to get the money, but it's not there.

I would like your help. Mr. Chairman, I know you have been personally involved in this kind of an issue. I would encourage you to intercede now and intercede as forcefully as you can to see if we can't get this money moved.

[The prepared statement of Mr. Dorgan appears at the conclusion of the hearing.]

Mr. JONES of Tennessee. May I reply, Mr. Dorgan, to your request?

Mr. DORGAN. Yes.

Mr. JONES of Tennessee. Following the testimony to be heard by you and Mr. Lightfoot, Mr. Vance Clark, Administrator of the Farmers Home Administration will be here. We will again convey to him your story and continue to insist that operating money be made available as soon as possible.

One question I would like to ask you just for the record: Do you know how much money has already been sent to the State of North Dakota for operating loans?

Mr. DORGAN. Well, the need for operating loans in North Dakota has already exceeded $30 million beyond what was allocated at the beginning of the year. I think that's the reason there was the need for a national transfer. That condition exists pretty much around the country. The reason for that, of course, is you have these farmers graduating down rather than up, away from the commercial bankable situation, into a Farmers Home need. This drives up the demand for those operating loans. And that's what has happened in our State.

Mr. JONES of Tennessee. That was the real reason that this subcommittee made a request some several weeks ago to the acting Secretary of Agriculture, Frank Naylor, for a transfer of these funds at that time.

Mr. DORGAN. And I appreciate the action of this subcommittee in doing that. I think that it gave voice to the concern of a whole lot of farmers out there who are dependent on that in order to get out in the field on their tractors this spring and get some planting done.

Mr. JONES of Tennessee. Well, we know how bad that situation is in all the States that we represent, and we hear from all the rest. So, we are going to stay on top of it and do all that we possibly can. Mr. Coleman.

Mr. COLEMAN. Mr. Chairman, I am not sure what the ground rules are here, if we are going to have Mr. Dorgan stay around or not. But in the event he is going to leave, which would be appropriate, in any event, if he didn't want to stay, I would say that we certainly have a friend, American agriculture has a friend on the Ways and Means Committee because Byron is on that important committee. When we have tax issues that come up, he is one of the first that we visit with and talk to about these issues. I am glad that he is here today expressing himself on the farm credit issue, as we have been able to express ourselves to him on the tax issues through the years.

Mr. DORGAN. Thank you very much.

Rather than deal with the prepared statement, which is on the longer term debt problem, let me say that we have a very serious problem. Some people on this committee and elsewhere in Congress have addressed some serious and thoughtful proposals to deal with it. I have commented on those. But let me stay around for a few minutes and turn it over to my colleague for his statement. I would be glad to answer some questions.

Mr. JONES of Tennessee. Very good. We will hear both of you. Can you stay, too?

Mr. LIGHTFOOT. Sure.

Mr. JONES of Tennessee. Congressman Lightfoot, you are recognized.

STATEMENT OF HON. JIM LIGHTFOOT, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF IOWA

Mr. LIGHTFOOT. Thank you, Mr. Chairman.

Before we begin, I would like to second what Mr. Dorgan just had to say. The Secretary of Agriculture was in my district last week. We had identified the very problem that Byron was speaking of. The Secretary kept saying over and over again, the money's there, the money's there. But it's not getting to the pipeline. We are having problems at the local level, at the State level, and certainly at the national level.

One of the commitments we were able to extract from the Secretary was to send some of those people and those bureaus out to hear the story first hand, and maybe we can unplug it. I would encourage you, as Mr. Dorgan did, to impress that upon Mr. Clark when he shows up here in a few minutes.

One other quick sidebar: the guaranteed loan program also is something, I think, that could be very valuable. But the banks aren't picking up on it because they are having to write down their assets. I think all of our colleagues in this room should exert whatever pressure we can to try to get something through the banking side which will relieve that writeoff situation that these rural banks face, where they could amortize this out over a series of maybe 6 or 7 years, something of that nature.

Since I came to Congress last year, I have shared your profound concern for the economic conditions in rural America. In this common goal, we seek to improve the financial position of the farm community. I welcome this opportunity to let you know of the proposal I introduced to assist in resolving the farm credit crisis. It is my hope that you will consider this proposal along with others that you are reviewing for action.

On January 29, I introduced H.R. 4073, which is known as the Agricultural Investment Act. This legislation was drafted with the advice of rural ag bankers in my district and offers a realistic, less costly alternative for providing lower cost loans for farmers.

The measure creates agricultural savings certificates similar to the All Savers proposal considered a few years back for the savings and loan industry. H.R. 4073 provides that these savings certificates can be issued by most banks and lending institutions at various rates and terms, with the interest earned on them tax free. The pool of money created by the purchase of these certificates can be loaned, by the U.S. Treasury and Secretary of Agriculture, to ag banks for making lower interest loans to bona fide farmers.

My point in this proposal is to lower interest expenses to farmers who otherwise might not cash-flow, one of the most difficult problems cited by farmers, and do this at less cost to the Government than any kind of a direct credit subsidy outlay.

Granted, there would be some revenue loss by nature of the interest on the bonds being tax exempt. But the cost to the Treasury would still be much less than a credit subsidy outlay.

Although the congressional tax committees are reluctant to consider tax-exempt instruments such as this, the temporary nature of the proposal as well as the public interest being served in this area more than justify the use of such a tool at this time. Moreover, it is likely that Congress will preserve the use of some types of tax-exempt bonds where they are demonstrated to be in the public interest.

I have attached a short summary of H.R. 4073 and a flow chart with our testimony. You can look that over at your convenience.

With that, I would be happy to answer a question or two. Thank you for the opportunity to be here.

[The prepared statement of Mr. Lightfoot appears at the conclusion of the hearing.]

Mr. Jones of Tennessee. Thank you very much for your statement and yours, Byron.

The Chair recognizes Mr. Coleman for any questions.

Mr. Coleman. Again I welcome our colleagues. Having already made a few comments about Mr. Dorgan, I would also like to tell Mr. Lightfoot how much we appreciate his leadership on farm issues in this Congress.

As a new Member of Congress, I don't know of anybody else who has had as much impact as that gentleman from Iowa has on the important issues that affect Iowa and his district. We have adjoining districts, so we have adjoining problems. Southern Iowa and northwest Missouri border each other and it doesn't cease to amaze me that we have similar problems. A lot of it is weather. A lot of it is directed at that particular part of the country. I know that Mr. Lightfoot has worked diligently on behalf of his constituents. This suggestion here, a very credible one, I think we ought to take a long, good look at and, hopefully, get something moving on it.

Jim, thank you for being here today.

Mr. LIGHTFOOT. Thank you. I appreciate the comments.

Mr. JONES of Tennessee. Thank you very much, Tom.

Mr. Gunderson.

Mr. GUNDERSON. Let me just be very brief. I can't help but say this is sort of like the before and after testimony. Mr. Lightfoot, I understand, is probably going to be serving on this committee sometime in the future, and Mr. Dorgan already has and has left us. I don't know if you knew the depth of the agricultural crisis when you decided to get off this committee or not, but I have to tell both of you that you are now not just both friends but friends of agriculture. We badly need the kind of assistance both of you have given us out there in the Halls of Congress. This committee is sometimes accused of being parochial. I don't think we are. But we need help outside the committee, and you have been special friends. Thank you both for your testimony.

Mr. DORGAN. Thank you.

Mr. LIGHTFOOT. Steve, if I could just make one brief comment, I think one of the things that we really need to be diligent about, all of us as a group, this particular piece of farm legislation gives the Secretary of Agriculture more discretionary authority than anything we have ever had in history. The actions he takes are going to have a very direct effect on how people are able to repay whatever credit system that is devised to help them. I think it behooves all of us to really keep the Secretary of Agriculture in tune with what is going on.

Mr. JONES of Tennessee. Thank you very much, Steve.

Mr. Evans.

Mr. EVANS of Iowa. I, too, want to welcome you both with your excellent testimony. I have one technical question to ask.

Byron, you talked about the need for the direct loan funds. It was seconded by Mr. Lightfoot. I would like to know to what extent you think it would be useful to have the advance commodity loan available at this point in time. Would that really help this fellow you were talking about, who is sitting there, for planting money?

Mr. DORGAN. Yes. In the short term, anything that provides some liquidity is helpful. The ability to get fuel, seed, and fertilizer is dependent on some resources made available to those folks.

Mr. EVANS of Iowa. Would an advance on 50 percent of the commodity loan cause him a problem next fall? The point was made earlier. Do you think he is going to manage to——

Mr. DORGAN. Well, I don't know. The problem is, you don't spring plant in the long run; you spring plant at spring. And if you don't have the money to put the crop in, you sure aren't going to have a shot at making a living trying to harvest it in the fall.

When you talk to these folks, as I am sure you find in your district, they are interested in surviving in the short term. There is an abundance of hope out there that somehow, some way, this thing is going to turn around. And if you can simply keep moving until it turns around, you're going to be able to survive.

Mr. **Evans** of Iowa. Thank you very much.

Mr. **Jones** of Tennessee. Thank you, Mr. Evans.

Mr. Franklin.

Mr. **Franklin**. Thank you very much, Mr. Chairman.

I, too, want to welcome my colleagues and want to take just a minute to lobby my colleague on the Ways and Means Committee about something that is directly bearing on the question that we are discussing here today, debt and farm credit. The Farmers Home Administration has been very helpful in coming to my district, even though we are experiencing the same bottleneck that you described earlier. The money that is available is not being put in the pipeline. However, as a part of the efforts that they are making on those cases, one of which I gave an example earlier in this room when you weren't here, of those farmers who are not going to be able to be financed under any circumstances, the Farmers Home has announced in my district the new homestead provisions allowing the farmer to save his home and 5 acres and have it financed for 35 years on a separate note, and at the same time to apply new regulations that I understand are now being promulgated concerning debt settlement. Authority is given to the State to write down or write off that debt when a farmer voluntarily turns his property in and his land in.

There are tremendous tax consequences to fellows who are in the position of being broke. Many times they are not able to have losses that they can go back and pick up that tax consequence and liability on. It is causing the program to actually be ineffective for many because of the tremendous tax liability that is there. If we could get some assistance—and I have spoken with Mr. Shelby about this—on your committee, he has indicated a willingness to help. If you can understand that that is a problem and be able to work through the taxing committee with that problem, I think that this debt settlement and homestead provisions, the regulations for which are now being promulgated, can work for many, many farmers out there to get rid of this umbrella of debt that is over them and let them at least start to do something else without fear of losing their home and putting their family in the street, et cetera.

Mr. **Dorgan**. Mr. Franklin, to be very brief, we in passing the Tax Reform bill this past December included a provision in that bill that I helped write, which deals with the alternative minimum tax and the capital gains that a farmer would face upon liquidation. We dealt with it by defining insolvent farmers who are forced to sell everything. What they sell goes exclusively to pay their debts. However, they end up with a tax at the end because they bought land for $200 that was sold for $350. Even if they lost it all, they might have a $35,000 tax bill hanging over their head that won't go away.

We dealt with that on the Tax Reform bill by eliminating that tax consequence for the insolvent farmer. You are raising another issue with respect to certain debt settlements. We have not dealt with it and want to. I am doing some work on it now.

For example, if someone is able to get a loan written down from $300,000 to $270,000, a 10-percent write-down, we don't want there to be an ordinary income tax consequence to the farmer as a result of the ability of that lender and farmer to agree on conditions that will provide for a cash-flow.

Mr. FRANKLIN. Thank you very much. This is extremely important because I think we have an opportunity to solve many individual problems with the combination of new programs, of the homestead provisions, and also the debt settlement, where a farmer voluntarily turns in his assets. That program is not going to work in several individual cases I know about because of the unbelievable tax consequences that are incurred in trying to get into that program.

Mr. DORGAN. I will keep working on that if you will help me light a fire under Farmers Home to get some more of that money out for spring planting.

Mr. FRANKLIN. I will do it and just as soon as they sit in the seat that you're in.

Mr. DORGAN. I appreciate that.

Mr. FRANKLIN. Thank you, Mr. Chairman.

Mr. JONES of Tennessee. Thank you very much, Mr. Franklin.

Mr. LIGHTFOOT. Mr. Chairman, if the gentleman will yield.

Mr. JONES of Tennessee. Yes.

Mr. LIGHTFOOT. The alternative minimum tax, which went into the tax bill, was finally picked up on the debt reconciliation. The President signed it yesterday morning, so that part of it is taken care of. It goes back to December 31, 1981, which started out over here. So, that part of it is taken care of, fortunately.

Mr. JONES of Tennessee. Thank you, Mr. Lightfoot.

Gentlemen, I want to join my colleagues here on the subcommittee in thanking both of you for your contribution that you have always made to agriculture, and the concern that you have had for the legislation considered in this subcommittee.

Byron, I assure you that Mr. Clark will be hearing your request pretty soon.

Mr. DORGAN. Thank you, Mr. Chairman.

Mr. JONES of Tennessee. He already has, a time or two.

Thank you very much, gentlemen.

Is Mr. Vance Clark in the room yet?

[No response.]

Mr. JONES of Tennessee. We are ready for the 2 p.m. panel. Mr. William Taylor is Director of the Division of Bank Supervision and Regulation, Board of Governors of the Federal Reserve System. Mr. John Downey is Chief National Bank Examiner, Office of the Comptroller of the Currency, Department of the Treasury. Mr. David Meadows is Associate Director, Division of Bank Supervisor, Federal Deposit Insurance Corporation.

Mr. Clark will join this panel when he arrives. He is no doubt continuing to testify before the Appropriations Committee at this time.

Mr. Downey, you are recognized. You may proceed.

STATEMENT OF JOHN F. DOWNEY, CHIEF NATIONAL BANK EXAMINER, OFFICE OF THE COMPTROLLER OF THE CURRENCY, U.S. DEPARTMENT OF THE TREASURY

Mr. DOWNEY. Thank you, Mr. Chairman and members of the subcommittee for the opportunity to appear before you today to discuss the effects of the downturn in the agricultural sector on national banks. I would like to use my allocated time before you today to present the highlights of my written testimony.

I appreciate your including my written statement in the hearing record.

As you are well aware, the American agricultural economy continues to experience severe difficulties. These problems are being increasingly reflected in the performance of national banks that lend to that sector. Particularly troubled are the 810 national agricultural banks defined by my office as banks having more than 25 percent of their portfolio in agricultural credits.

In 1985, 178 of these banks reported losses, compared with 134 at year end 1984, and only 78 at year end 1983. The median ratio of classified assets or problem credits to gross capital funds at all national agricultural banks reached 52 percent as of September 30, 1985. That is, for every dollar of capital in those banks, there was 52 cents of problem credit.

Problem loans were 30 percent of gross capital in September 1983. In contrast, the ratio for nonagricultural banks rose only slightly over the same period, from 19 percent in September 1983, to 24 percent in September 1985.

The deteriorating condition of many national agricultural banks is also reflected by their increasing presence among the ranks of problem and failed banks. As of year end 1982, only 1 percent of the national agricultural banks were problem banks. By December 1985, 103, or 13 percent of the approximately 810 national agricultural banks, were problem institutions.

Of the 30 national banks that failed in 1985, 10 were agricultural banks. Five of the eight national banks that failed in the first quarter of this year were agricultural banks. We are aware of disruption faced by the communities when a local bank experiences significant deterioration or, in the extreme, fails.

Despite the serious problems facing many agricultural banks, we believe that a majority have sound prospects for the future. Even with larger losses and the likelihood that these losses will continue in the coming months, agricultural banks remain basically sound. As of December 1985, 93 percent of the national agricultural banks reported capital in excess of 7 percent of assets. Fifty-seven percent had capital in excess of 9 percent. While 22 percent reported year end losses, almost 35 percent of the agricultural banks reported a return on assets in excess of 1 percent, the industry benchmark.

For these reasons, we are optimistic that the bulk of the agricultural banking sector possesses the resource, management talent, and willingness to work with their borrowers to achieve mutually satisfactory solutions.

We believe that the most beneficial thing that we can do as a regulatory agency is provide banks with the opportunity and incentives to work with their borrowers to restructure problem loans.

However, many banks have been reluctant to write down loans or to grant other concessions to borrowers because this may reduce their capital levels. Banks fear that reduced capital levels are unacceptable to bank regulators. Furthermore, they are reluctant to reduce capital because it is the basis for determining the amount that a bank can loan to any one borrower.

In response to these concerns of the Comptroller of the Currency in conjunction with the Federal Reserve Board and the Federal Deposit Insurance Corporation decided to institute supervisory policies that would give the banks the tools and the encouragement to restructure problem loans during this difficult but transitionary period. On May 28, of this year, the Comptroller issued a five-point program.

First, we again encourage banks to enter and to work out plans with their agricultural borrowers who are experiencing temporary difficulties.

Second, we repeated our prior encouragement to banks that they familiarize themselves with the opportunities afforded by financial accounting standard No. 15. Under this accounting rule, a bank need not recognize any loss on a restructured loan when the expected payments, principal and interest combined, equal or exceed the loan amount on the bank's books prior to the restructuring.

Third, we are modifying the reporting requirements for restructured loans so that only restructured loans not being paid in accordance with the modified terms are categorized as problem loans. Previously, all restructured loans were reported with problem loans.

Fourth, we instituted a capital forbearance policy to allow well-managed banks whose capital fell below historical levels as a result of problems in the agricultural sector up to seven years to restore their capital. The policy formally acknowledges that capital should be used during periods of unusually heavy loan losses and that capital replenishment takes time.

Fifth, we are amending the rules that limit the size of loans that a bank can make to a single borrower. For banks suffering agricultural losses, we are increasing the current general lending limit of 15 percent of capital to a maximum of 20 percent of capital. Thus, a bank who capital declines as much as 25 percent because of found loan losses will still be able to keep its old general lending limit in order to meet the credit needs of its customers.

We believe that these policies will provide agricultural banks with the incentives and the time to meet the needs of the borrowers they serve. Furthermore, these policies preserve the integrity of banks' financial statements, which is vital to insuring confidence in the banking system. However, in order to improve their ability to withstand future downturns in the farm sector, agricultural banks need to diversify their assets. We have therefore supported Federal and State legislative proposals that would increase small agricultural banks' ability to diversify.

We have encouraged the States to enhance intrastate branching opportunities and to remove restrictions on farm ownership. We have encouraged Congress to expand the powers of national banks and to ease Glass-Steagall prohibitions, of particular relevance with respect to underwriting interests in pools of bank loans.

I will not go into detail on some of these matters, which more appropriately should be and have been the subject of other hearings.

You requested comments on H.R. 3868 and H.R. 4267. My comments relate with respect to H.R. 3868 on the bill as introduced. We understand that significant changes may be made by introduction of substitute provisions. These bills are intended to assist lenders and farm borrowers through the downturn in the agricultural economy. They may, however, create additional inappropriate cost to the Federal Government. We defer to the Department of Agriculture on the need for these specific bills. Nevertheless, we do have some comments on how these bills may impact national banks.

We favor voluntary programs that augment a farm lender's ability to grant concessions in order to improve the ability of troubled borrowers to service their debt. However, as I indicated in more detail in my written statement, any loan restructuring program should contain sufficient flexibility for the lender and the borrower to design mutually satisfactory restructured terms. Statutory limitations on maturity, interest rate, and transferability of restructured loans may lessen the attractiveness of such programs to banks and may actually result in less attractive loan terms to the borrowers as banks attempt to restructure loans within the proposed statutory constraints.

We also recommend that program audits and monitoring of national banks' participation in restructuring programs be conducted by national bank examiners. To do otherwise would result in a duplication of effort by the State agency and the Federal regulator and would unnecessarily increase the regulatory burden on our banks. Historically, Congress has preserved the exclusive jurisdiction of my office over national banks regardless of the subject matter. We are opposed to the provisions in both bills that would permit the loan portion of certain agricultural loans to be amortized on a bank's financial statement over a ten-year period. Loan loss amortization distorts a bank's condition to the public and therefore undermines the integrity of financial reports of both the participating banks and the commercial banking system as a whole.

Furthermore, we believe the statutory creation of an interagency task force to assist agricultural lenders is unnecessary. The financial institution regulatory agencies are already working together on the problems of agricultural lenders and the agencies' recent actions addressing those areas that H.R. 3868 proposes to be addressed by an interagency task force.

Overall, therefore, we would oppose adoption of both bills in their current form. Nevertheless, working together, banks, their supervisors, and Congress, can assist lenders and their farm borrowers through the downturn in the agricultural economy.

Our recent capital forbearance and lending limit actions and your reference to develop appropriate legislation are examples of the kinds of actions that are needed.

I appreciate the opportunity to share our views with you. I would be happy to answer any questions you may have.

[The prepared statement of Mr. Downey appears at the conclusion of the hearing.]

Mr. STENHOLM [acting chairman]. Thank you, Mr. Downey. We will hear from each of the witnesses before we question you.

Mr. William Taylor is Director, Division of Banking Supervision and Regulation, Board of Governors of the Federal Reserve System.

STATEMENT OF WILLIAM TAYLOR, DIRECTOR, DIVISION OF BANKING SUPERVISION AND REGULATION, BOARD OF GOVERNORS, FEDERAL RESERVE SYSTEM

Mr. TAYLOR. Thank you, Mr. Chairman.

Mr. STENHOLM. Without objection, your statement, as Mr. Downey's, in its entirety will be made a part of the record. We would appreciate very much a summary for this committee today.

Mr. TAYLOR. Thank you, Mr. Chairman. I will summarize.

I am pleased to appear before this subcommittee today to review the problems being experienced by banks in our agricultural communities and to discuss various proposals to ease the strains resulting from these problems.

I think Mr. Downey and others have categorized those problems very accurately. In certain sectors they are fairly severe. The earnings of farm banks have declined steadily and substantially over the decade. Eighteen percent of those banks lost money in 1985. The average return on farm bank equity has dropped from 16 to 6 percent in the short space of 5 years.

In addition, the number of bank failures has increased dramatically in the farm sector, with the number approaching 70 last year.

It is important to note that many of the farm banks are in a strong position. It is modestly encouraging to see recent developments that should work to assist the basic farm economy, including the fall in energy prices and the substantial decline in interest rates.

Having noted all that, I should go on to point out that the prospective supply conditions for farm products suggests that a substantial rebound in farm incomes is not likely to take place in the near future. Accordingly, while farmers that are now financially healthy should be able to avoid serious problems, many other farmers with relatively heavy debt loads face a continuation of serious difficulties.

You have asked that I respond to certain legislation that has been proposed. Like Mr. Downey, I find it very difficult to comment on the budget considerations, as those really are not within my area of expertise. However, I would echo Mr. Downey's concerns regarding the use of loss deferral as a means of dealing with the farm bank question.

We think that the program that we have proposed, as outlined by Mr. Downey, will go a long way toward providing bankers the latitude to deal prospectively with their farm customers and allow those farm customers to adjust their borrowings where such an adjustment will result in the eventual repayment of the loan.

I don't think it is in the interest of the committee's time for me to again go over the specifics of the program. We have already intiated this program and have talked with all of our regional banks.

They are actively pursuing a plan to implement the program in the farm bank sector.

The other point I would like to make is that, given the difficulties we have in the banking business, it would be helpful to have a little more flexibility in the way of dealing with problem banks. Emergency bank legislation which would lower the size of the bank that an out-of-State institution could acquire and the ability to provide assistance to the holding company of the bank as well as the bank would also be helpful.

That would conclude my formal remarks.

[The prepared statement of Mr. Taylor appears at the conclusion of the hearing.]

Mr. STENHOLM. Next we will hear from Mr. A. David Meadows, Associate Director, Division of Bank Supervision, Federal Deposit Insurance Corporation.

STATEMENT OF A. DAVID MEADOWS, ASSOCIATE DIRECTOR, DIVISION OF BANK SUPERVISION, FEDERAL DEPOSIT INSURANCE CORPORATION

Mr. MEADOWS. Mr. Chairman and members of the subcommittee, we welcome the opportunity to present the FDIC's views on current farm bank problems and regulatory responses. We have provided a statement for the record, which I would like to summarize for you. In the interest of time, I will try not to duplicate comments that my colleagues made previously.

There are indications that the problems in the farm economy may have bottomed out. Recovery will take time, however. We would expect the number of problem banks and farm bank failures to continue at or near the present level for the next year or two. In the interim, the FDIC and the other bank regulatory agencies have taken steps to deal with the specific problems faced by farm bank lenders. These include a capital forbearance policy, continued recognition of financial accounting standard board statement No. 15, and changing the manner in which renegotiated debt is reported on reports of condition filed with the agencies.

Furthermore, we think that individual States in the farm sector should take action to liberalize branching laws and other laws which might impede recovery in the farm economy.

We also think it is vitally important that the Garn-St Germain Act of 1982 be extended and be eased to allow failing bank acquisitions across Statelines and also a reduction in the size criteria.

This concludes my opening statement. I will be pleased to answer any questions you might have.

[The prepared statement of Mr. Meadows appears at the conclusion of the hearing.]

Mr. STENHOLM. Next we will hear from Mr. Vance L. Clark, Administrator of the Farmers Home Administration, USDA.

STATEMENT OF VANCE L. CLARK, ADMINISTRATOR, FARMERS HOME ADMINISTRATION, U.S. DEPARTMENT OF AGRICULTURE

Mr. CLARK. Thank you, Mr. Chairman and members of the subcommittee.

I, too, appreciate this opportunity to discuss ways of assuring farm credit at low interest rates to financially troubled farmers throughout our Nation. More specifically, you have asked me to comment on the proposed Farm Credit Partnership Act, H.R. 3868, and the Debt Adjustment Amendments, H.R. 4267, to the Consolidated Farm and Rural Development Act.

First, Mr. Chairman, I am encouraged by the attention being given to the concept of using guaranteed loan programs to meet specific farm credit needs. The Farmers Home Administration, as "a lender of last resort," is committed to moving toward an all guaranteed program. The legislation before us, to a large extent, is a recognition that credit from the private sector is available even to hard-pressed farmers if they can show a chance of success and if the credit risk can be shared.

Having said that, let me quickly add that, because of recent changes in Farmers Home programs and funding, I do not believe that further legislation in this field is necessary.

In recognition of the fact that in the long run, guaranteed lending is less expensive to the Government, Congress increased fiscal year 1986 appropriations for Farmers Home guaranteed loans from $1.1 billion in fiscal year 1985 to $2 billion this year. As of last Friday, April 4, Farmers Home had guaranteed over 4,825 farm loans for a total of $513.7 million so far this fiscal year. So, it is going.

That compares with 1,767 guarantees last year, for $220.5 million, at the same time last year. Last year, fiscal year 1985, was the first year that guaranteed loans have played a significant role in Farmers Home Administration's farm lending. Guarantees reached $1 billion for the first time in the history of our agency. In 1984 farm loan guarantees amounted to $443 million; the year before that, some $70 million. So, you can see it has indeed been growing.

We have great expectations. I have great expectations for guaranteed lending this year, especially since the private lending institutions are showing, I think, even greater interest in the program. Farmers Home has lined up some 2,200 approved lenders throughout the Nation. These lenders are aware of Farmers Home requirements. They have agreed to handle much of the guaranteed loan processing work, using their own documentation, not our documentation, thereby, I think, reducing paperwork that is normally required in that type of a loan.

In many parts of the country, independent banks and the Farm Credit System lenders are beginning to recognize the advantages of guaranteed loans for their hard-pressed customers.

Before I go on, I would really like to publicly acknowledge my appreciation to those Members of Congress who have helped set up information meetings between our people at Farmers Home and the local lenders throughout the United States to discuss the mutual benefits of guaranteed loans. Believe me, that assistance has been invaluable.

In other areas of the country, there is still a good deal of work to be done, I think, to convince local lenders that there are benefits to guaranteed loans. It has not been universally embraced throughout the United States as a panacea for all our ills. We do strongly suspect that persistent negative views that we are picking up are based on isolated adverse experiences. In our early attempts at the guaranteed program, I have heard that we indeed picked too many nits as we went along the line. We are trying to overcome that.

That system has been greatly improved. For instance, recent regulations allow a line of credit to be established through a guaranteed loan program, permits the use of guaranteed loans for refinancing purposes, allows multinote packaging for sale in secondary markets, and provides for settlement of loss claims prior to complete liquidation of that debt.

Farmers Home has agreed to shorten the turn around time between application by the lender and the loan decision by our agency. I think that is happening.

We have been working hard to get the word out on the improved guaranteed loan program. In addition to the kinds of meetings with bankers I mentioned earlier that you people in Congress have set up for us, we have done a number of teleconferences and videotapes on the subject to our fellow lenders throughout the Nation.

The American Bankers Association, I think, was especially helpful in producing and distributing the interview video type of program that went to 14,000 members. That answered many of the questions that I think were posed by those bankers.

We are going to continue to promote the concept of the guaranteed loans wherever we can. We expect that even reluctant lenders will ultimately, I think, become more involved as the benefits of our program become more evident to them.

The interest buydown program, mandated by the 1985 farm bill went into effect March 18. The first interest rate reduction agreement took place a couple of weeks ago in Iowa. We now have another one going in Arkansas and another one in Wisconsin. So, that is beginning to take hold. It is really too soon to have real solid evidence of the eventual success of that program. But there does appear to be a great deal of interest on the part of our banking friends building in that program.

That program offers a 2-percent buydown shared with the lender. It's a program that most private lenders were advocating last year, when we talked about our debt adjustment program and when we initiated the program. So, we are doing really what they asked us to do.

As I indicated, Mr. Chairman, we expect the Farmers Home program to grow in our guaranteed sector. The interest rate buydown program, we think, is going to be successful. These programs, in addition to our direct lending, should be sufficient to meet the credit needs during our fiscal year 1986 period.

For these and other reasons, we recommend against creating a new layer of bureaucracy to accomplish what we think Farmers Home is already doing. For the most part, the proposed Farm Credit Partnership Act and the Debt Adjustment Amendments are redundant and could in fact, we think, impede progress toward a greater use of guaranteed funding.

The FmHA interest buydown program is a reality. It is happening. It is already here today. It is in operation. There is nothing to prevent States from offering an additional interest rate reduction to lenders if they choose to do so. We are willing to work with them. The Farm Credit Partnership Act could require an entirely new and, we think, unneeded structure within the USDA and the States to achieve Federal-State lender cooperation.

Among other problems, I think it would, in my estimation, create an accounting nightmare, which we don't need.

A major concern is the cost of the proposed buydown system. The Federal Government would be called upon to contribute $600 million to the States for each of the 3 years of the program. In addition, the Federal Government would pay one-half of all State administrative costs. It appears that that total cost could run close to $2 billion for the next 3 years. I think that's unconscionable.

In contrast, the farm bill provided $490 million to Farmers Home over the next 3 years to accomplish, we think, the same goals. Our first year allocation for the program is $114.8 million. We project that those funds could generate as much as $5.7 billion in guaranteed farm loans.

The loan principal reduction features of title III of H.R. 3868 appear to be more restrictive than our current Farmers Home procedures. One of the major differences is that the guarantee could not be paid out unless the lending institution goes under, unless that lending institution is completely liquidated. We presently make a preliminary settlement prior to liquidation. That is an important and attractive feature for our participating lenders.

Mr. Chairman, I think for these and other reasons, we recommend against the passage of that proposed legislation. I, too, would join my associates here in answering any questions you might have.

[The prepared statement of Mr. Clark appears at the conclusion of the hearing.]

Mr. **Stenholm**. Thank you, Mr. Clark.

Mr. Coleman.

Mr. **Coleman**. Mr. Chairman, I am going to ask something I have never asked before, and that is for an additional 5 minutes on top of the present 5 minutes, if my colleagues would bear with me.

Mr. **Stenholm**. Without objection.

Mr. **Coleman**. Thank you, Mr. Chairman. My remarks mainly are going to be directed at Mr. Clark. I am somewhat sorry that he was not here earlier in the day. I recognize he was also testifying at other committees.

There is no ambiguity, I think, from the testimony we have received that we are in the middle of a financial credit crisis of the first magnitude. Spring planting is here. Farmers, at least in my State of Missouri, don't know whether they will be receiving the operating loans they need this year to put in their own crops. To me, this is an intolerable situation and, in many cases, completely unnecessary.

I am most deeply concerned about the numerous and continuing problems with programs operated by the Farmers Home Administration in the State of Missouri. First, the State Director decided to distribute direct operating loans on a county-by-county basis. Such a distribution, with no provision for a State pooling fund, resulted in pockets of credit shortages in some areas of the State while there were actual surpluses in other areas of the State and other county Farmers Home offices.

This particularly penalized counties in north Missouri, whose needs exceeded their allocations. By mid-February, the counties' allocations were completely exhausted, while statewide, there was shown a $20 million unobligated fund balance. So, at my urging, the State pool was finally created to provide funds to counties where allocations had been exhausted. But I am afraid that help may be too late for hundreds of farmers who were turned away during that period of time that those county offices were out of funds.

As of April 7, 56 percent of the additional $700 million which the administration transferred into the direct operating loan program was already allocated nationwide. Because of our State's Farmers Home Administration distribution policy, Missouri did not receive its first allotment until just yesterday, April 8, when we received $2.4 million, which to me is a drop in the bucket as far as I am concerned.

I am also angered. I am frustrated by the failure of the Farmers Home Administration Guaranteed Loan Program and its administration in my State. In late February, statistics indicated that Missouri's Guaranteed Loan Program was far behind those of its neighboring States. At that time, Missouri's participation was 3 percent of its allocated funds, while Kansas had 36 percent, Iowa 43 percent, Oklahoma 75 percent, and Nebraska at 84 percent. So, on February 28, I did, as you recommended in your testimony, took it upon myself to meet with our Farmers Home Administration people in our State office, along with farm credit representatives from both commercial lenders and the Farm Credit System in order to try to get this guaranteed program working for our State.

At the meeting, lenders told me and told the Farmers Home Administration that the officials in Missouri were more rigid in their interpretation of lending practices and guidelines than they were in their counterparts in the surrounding States. The Missouri Director told me and the lenders at the meeting that he would be more flexible and would go that extra mile in making the program work in Missouri.

Following that meeting, I wrote to 130 lenders in our State, urging them to use the guaranteed loan program and emphasizing the cooperation that they would have and that would be necessary for them as well as for the Government to make these loans work for spring planting. Since then, I have heard from a number of bankers in my district and phone calls and letters telling me essentially the same story. I would like to have this subcommittee and Mr. Clark listen to at least one of those letters that I am going to share with you now.

This is in response to my letter again trying to make this program work: "Received your letter dated March 5, asking for our cooperation with the State Farmers Home Administration in order to make a federally guaranteed loan program a success—he writes. I noticed in your letter that you state the Missouri State office will go the extra mile to make the guaranteed program work. I am telling you here and now, Mr. Coleman, that is a joke. Our farm lending officers have just returned from a meeting with officials from the Missouri State office that was held in St. Joseph, MO"—in my district—"and they tell us to forget the guaranteed loan program.

It is cumbersome. It is unworkable, and it puts stress and paperwork on the banks. Being in the northwest part of Missouri, we have occasion to deal with two Iowa Farmers Home offices. We are currently involved in doing guaranteed programs with these offices as their rules and regulations are far less rigid and restrictive."

Another banker said that he had 9 to 10 guarantee applications pending since January. He said that Farmers Home officers in Missouri would look at an application and kick it back because something was on the wrong line or the T wasn't crossed or the I wasn't dotted.

Now, it seems strange to me that the program is flourishing in our neighboring States. In Nebraska, Iowa, Kansas, Oklahoma, and Minnesota the participation rate in the guaranteed program is respectfully 75 percent, 63 percent, 43 percent, 84 percent, and 71 percent, as of April 4. Missouri, in comparison, has gone up all the way to 10 percent. At the same time, Nebraska has received almost a 100-percent increase in their allocated funds and have already obligated those in the meantime.

So, we are told by you and others in the offices here in Washington that these programs are going to work. But they are not working, Mr. Clark, they are not working, I repeat, in the State of Missouri.

When you've got the same banker making guaranteed operating loans in Iowa but not in Missouri, it's pretty clear that the problem lies at the doorstep of the Farmers Home in our State and not at the bank's door.

Missouri is out of step with the rest of the Midwest. Therefore, there is no excuse, while other States can utilize these programs that come to a dead standstill in Missouri. In the Missouri State Farmers Home office, they say the problem is not with the county supervisor. And I don't think necessarily that it is, because a large majority of these people are working under very difficult circumstances. But I am disturbed by reports of some unresponsive, arbitrary, and even abusive county supervisors.

While one situation in Livingston County has been widely publicized, I have earlier through the years, I might add, brought to the State director's attention to review the performances of other county supervisors in my district, where I believe the complaints were justified. Yet, in each instance the State director comes back and says that these supervisors were totally competent, qualified people, but maybe they do need some improvement of their communications skills.

Well, in Livingston County the communications skills are so poor apparently that the farmers have grown so frustrated that they are using tractors to block those offices at the Farmers Home.

Frankly, I am out of patience and agree with the banker who told me that the only way for Missouri farmers to receive any benefit from the Farmers Home programs is a complete change of personnel and/or philosophy at the State level. It seems to me that we have given the State Farmers Home Administration director the funds, the tools, and all the time necessary to make these programs work to the benefit of Missouri farmers; but we are out of time. The Farmers Home Administration's State director is not working up to the standard I believe he should. We must put emergency measures into effect and get someone running the program so it works for the farmers, not against them.

If the present State administrator can't meet the crisis, then it's time for him to leave and let someone else take over who can do the job. Therefore, Mr. Clark, I am asking you as the Administrator of this program to do the following.

One, replace the current director of the Farmers Home Administration State office. Two, within 48 hours dispatch a competent, experienced, high-level troubleshooter to take charge of the Farmers Home Administration office in Missouri. Three, dispatch to Livingston County and other troubled counties the personnel necessary to untangle the apparent mess which now exists. Fourth, design a crash plan to get Farmers Home programs working for Missouri farmers to make up for what they have lost and suffered as a result of current mismanagement problems and practices.

Mr. Clark, I do not hold you personally responsible for all of these problems in the State. You are new to the program. You are new to the Government. Frankly, I have been fairly impressed with your management and your testimony before our committee before last month. I know that you care. I know that President Reagan cares about our farmers. I care deeply for our farmers, too, and our State. Our farmers know that there is less money for their problems this year, and you alluded to that. What they cannot accept and what I cannot accept is the fact that in Missouri the Farmers Home Administration is not utilizing and making work for the farmers the money that is available.

So, there is really no time to waste to see if the State can get back on track or that we can boost them up again and have more conferences or some more seminars or some more telephone calls. It seems to me that we have to take these emergency steps today. That is why I am utilizing this forum and these definite suggestions for you to take and to follow at my request.

If you have a response, I would be happy to entertain one. You may feel that you don't want to.

Mr. CLARK. Mr. Coleman, I am terribly disappointed about the report you are giving me. I will tell you, I am one jump ahead of you in one of your requests. We indeed have sent a team to Livingston. We indeed have that response back from that investigation team. We are doing some changes in that office, not of the county supervisor. I don't think he should be run out of town because of tractors parked in front of the office. But we are making some reviews of some of those loans in that situation. So, I think we are a little ahead of you on that part of your problem.

We are, I think, perhaps putting more money out there. We have now put over $57 million out in your State. We gave the State about $2.5 million today, yesterday I think it was 860-some thousand. So, I think we are responding to the State director's request for additional funding.

It is kind of difficult to compare one State against the other, you know. Are your conditions the same as they are in some of those other States? I am sure you are aware of that as well. We try to be responsive to the unique needs of those States.

I will certainly work with you on the various situations you brought up. I will be happy to talk with you further about it.

Mr. **Coleman**. I appreciate that.

Let me say in regard to the Chillicothe, Livingston County situation that your review team has come in. Press reports indicate that this supervisor may have had "attitude problems." It seems to me that continuing the situation there just by giving him some more training is not going to solve that particular problem, that there are going to have to be supplemental personnel sent in there to assist him because it's obvious there is a complete breakdown of trust between many farmers in that community and the Farmers Home office.

Again, there are differences between States. But when I point to the States around us, and indeed where lenders are lending in other States, and they tell me these things, you can imagine why I draw the conclusions that I have.

I thank you.

Mr. **Stenholm**. Mr. Daschle.

Mr. **Daschle**. Thank you, Mr. Chairman.

I in large measure have to associate myself with the remarks of Mr. Coleman. I notice that he didn't mention South Dakota as he compared Missouri to the other States. I don't have many of the figures that he has, but I have to believe that in some respects South Dakota's situation is virtually identical to Missouri's.

I recently sent a survey out to all of the people in our banking community. I think that the response was best summarized with one letter that I got, which was probably the most brief of all the letters I received. It simply said: no money, no cooperation, no certainty, no better.

I think that really does sum up as best as I can the view of the Farmers Home Program in South Dakota right now. There is a tremendous amount of frustration, a tremendous amount of uncertainty, a tremendous amount of confusion, and certainly a tremendous lack of financial support for the kind of loan demand that there is in the State right now.

As with Mr. Coleman, I certainly can't put any of the responsibility for this on you, Mr. Clark. You are going into a difficult, difficult position. I certainly don't in any way expect you to be able to solve this thing overnight. But I have three concerns that I would like you to address if you would.

First of all, a number of farmers have told me that in many cases their loans were approved as early as last January. It is now April. They still don't have any funds. They are very concerned about why that funding has not been made available.

The second thing that I get, primarily from the bankers, is that the process of the guaranteed loan application is absolutely untenable. In most cases they want to wash their hands of it. I would ask you, if you could, to give me how many, the number of the guaranteed loans that you have already allowed this year.

Finally, they are still exasperated by something we talked about earlier. I would like you to address it if you could. That is the cost of money. They are perplexed, to say the least, and very concerned about the rate of interest that many of them are being charged. This interest buydown just doesn't seem to be working. Why, if we have this interest buydown, and if it's working to the extent that you indicated in your testimony, would farmers have to be spending so much for the cost of money today? Obviously, I haven't seen any change at all. We did this survey as late as yesterday. There does not seem to be any visible indication that the cost of money has gone down, in spite of the fact that we hear the interest buydown is now in effect.

If you could address those three things, I would appreciate it.

Mr. **Clark**. Mr. Daschle, I have got to tell you, yours is one of the worst States, the worst States for high interest rates from the independent bankers. I can't believe the rates they're charging out there. So, I can't respond to that. I don't know what's driving your bankers to do that.

Our rates, I know, are very attractive. We now have a 9.5-percent operating rate.

Mr. **Daschle**. I am not talking about Farmers Home. Why isn't the interest buydown working in South Dakota?

Mr. **Clark**. Because your bankers don't want to give up 2 percent. I don't know, you must have some terrible shareholders out there in those banks and demanding a great return on their bottom line. But something terrible is happening in that State. I can't respond to that.

We are willing to cooperate. But they won't even come down 2 percent. They don't want to gamble 10 percent on the farmers in your part of the country. To me, that's unconscionable. They're turning their back on the very substance of our economy in that State. If those bankers go down the tube, you know, the credit cards they're issuing, the new car loans they're making, the residents in town they're making aren't worth a hoot. I really can't drive that message home. I wish you could help me in that State.

Mr. **Daschle**. I would love to. I tell you what. If the two of us can team up in some way to see that that happens, it would probably be the most unlikely couple you'll see for the rest of the year. But we'll do it.

Mr. **Clark**. You know, I want to tell you, in both your States, Mr. Coleman and Mr. Daschle, we have sent teams into your States to be sure we are doing the right things in granting credit there. I am terribly disappointed to tell you that over 20 percent of the obligations, 20 percent of the credits that we are granting in your two States do not cash-flow. If we're erring in your States, it's on the side of compassion and leniency.

We have old-time county supervisors in your States that don't have tractors around their offices, they are giving the store away. They will not change the mindset that they have from years gone by, that they can come to you in Congress, turn the spigot on, and get more direct loan funds. It's hard to change that mindset that's out there. There is great compassion. They have in their own mind, in their own offices, a continuation policy: to hell with the cash flow; let's get the dollars out there. I am having a problem in both your States.

Mr. **Daschle**. In the short time that is left, let me re-ask the question. That was, could you tell me how many guaranteed loans have been made? Two, why the lag time between approval and actual availability of loan money?

Mr. **Clark**. There should not be a lag time. We have a committed turnaround time for those types of loans. If there is a holdup, usually when I dig into them, it's something the bank has done. They don't give us financial statements. The appraisals aren't in there. It's not a complete package. They are trying to jam something down us for guarantee that is not documented correctly. But, you know, that's a broad statement. But the ones I looked into, that's exactly what's happened.

Guaranteed loans in your State—you're talking about farm operating loans—we have booked $22,070,000 in guaranteed operating loans in South Dakota.

Mr. DASCHLE. How many loans though?

Mr. CLARK. Numbers? I haven't got those.

Mr. DASCHLE. The figure I have—and I was hoping you could verify it—is 175. If that's the case, I am very confused. I can't imagine, with all of the demands put upon this program, that all we can say is that we have authorized and approved 175 guaranteed loans. That's preposterous. With $22 million, I sure hope it's more than 175 loans.

Mr. CLARK. It has to be.

I would be glad to furnish those numbers for you.

Mr. DASCHLE. Could you call my office or something?

Mr. CLARK. I would be happy to.

Mr. DASCHLE. I would be interested in knowing.

[The information follows:]

Farmers Home Administration Guaranteed Farm Operating Loan Allocation (thousands), Fiscal Year 1986, a copy of which is attached, reflects that South Dakota was allocated $36,813,000 in Guaranteed Farm Operating Loan funds.

The Form FmHA 389-175, "Status of Loan and Grant Obligations/Allotments or Distribution Fiscal Year 1986, as of April 16, 1986, reveals that South Dakota has made 256 Guaranteed Farm Operating Loans in the amount of $24,786,590. The state has used 59 percent of its Guaranteed Farm Operating Loan allocation for Fiscal Year 1986. A copy is attached.

Farmers Home Administration Fiscal Year 1986
Guaranteed Farm Operating Loan Allocation (thousands)

FmHA Instruction 1940-L
Exhibit A, Attachment 1
Page 9

States	State Basic Formula Factor	Formula Allocation	Transition Range		Transition Amount	Base Allocation	Administrative Allocation	Total FY1986 Allocation
			Low	High				
Alabama	.0152150	24,556	0	0	24,556	0	0	24,556
Alaska	.0000000	0	0	0	0	0	200	200
Arizona	.0044166	7,128	0	0	7,128	0	0	7,128
Arkansas	.0193473	31,225	0	0	31,225	0	0	31,225
California	.0335320	54,118	0	0	54,118	0	0	54,118
Colorado	.0142900	23,063	0	0	23,063	0	0	23,063
Delaware	.0029731	4,798	0	0	4,798	0	0	4,798
Maryland	.0100994	16,300	0	0	16,300	0	0	16,300
Florida	.0121931	19,679	0	0	19,679	0	0	19,679
Georgia	.0176606	28,503	0	0	28,503	0	0	28,503
Hawaii	.0036094	5,825	0	0	5,825	0	0	5,825
W. Pac. Terr.	.0000000	0	0	0	0	0	200	200
Idaho	.0132404	21,369	0	0	21,369	0	0	21,369
Illinois	.0575895	92,945	0	0	92,945	0	0	92,945
Indiana	.0350601	56,584	0	0	56,584	0	0	56,584
Iowa	.0722626	116,626	0	0	116,626	0	0	116,626
Kansas	.0376933	60,834	0	0	60,834	0	0	60,834
Kentucky	.0330097	53,275	0	0	53,275	0	0	53,275
Louisiana	.0150860	24,348	0	0	24,348	0	0	24,348
Maine	.0064900	10,474	0	0	10,474	0	0	10,474
Massachusetts	.0031949	5,156	0	0	5,156	0	0	5,156
Connecticut	.0028536	4,605	0	0	4,605	0	0	4,605
Rhode Island	.0016893	2,726	0	0	2,726	0	0	2,726
Michigan	.0225967	36,469	0	0	36,469	0	0	36,469
Minnesota	.0490631	79,184	0	0	79,184	0	0	79,184
Mississippi	.0161980	26,142	0	0	26,142	0	0	26,142
Missouri	.0394718	63,705	0	0	63,705	0	0	63,705
Montana	.0158561	25,591	0	0	25,591	0	0	25,591
Nebraska	.0389508	62,864	0	0	62,864	0	0	62,864
New Jersey	.0048890	7,890	0	0	7,890	0	0	7,890
New Mexico	.0082061	13,244	0	0	13,244	0	0	13,244
New York	.0202533	32,687	0	0	32,687	0	0	32,687
North Carolina	.0271393	43,801	0	0	43,801	0	0	43,801
North Dakota	.0234151	37,790	0	0	37,790	0	0	37,790
Ohio	.0349690	56,437	0	0	56,437	0	0	56,437
Oklahoma	.0265791	42,897	0	0	42,897	0	0	42,897
Oregon	.0130411	21,047	0	0	21,047	0	0	21,047
Pennsylvania	.0230289	37,167	0	0	37,167	0	0	37,167
Puerto Rico	.0000000	0	0	0	0	0	475	475
South Carolina	.0112925	18,225	0	0	18,225	0	0	18,225
South Dakota	.0228096	36,813	0	0	36,813	0	0	36,813
Tennessee	.0247459	39,938	0	0	39,938	0	0	39,938
Texas	.0605189	97,676	0	0	97,676	0	0	97,676
Utah	.0085182	13,748	0	0	13,748	0	0	13,748
Nevada	.0046301	7,473	0	0	7,473	0	0	7,473
Vermont	.0053261	8,596	0	0	8,596	0	0	8,596
New Hampshire	.0051345	8,287	0	0	8,287	0	0	8,287
Virgin Islands	.0000000	0	0	0	0	0	200	200
Virginia	.0181192	29,243	0	0	29,243	0	0	29,243
Washington	.0140718	22,711	0	0	22,711	0	0	22,711
West Virginia	.0043858	7,078	0	0	7,078	0	0	7,078
Wisconsin	.0397636	64,175	0	0	64,175	0	0	64,175
Wyoming	.0055205	8,910	0	0	8,910	0	0	8,910
State Totals	1.0000000	1,613,925			1,613,925	0	1,075	1,615,000
Reserve								45,900
Total								1,660,900

FORM FMHA 389-175
REVISED: 2-17-76

UNITED STATES DEPARTMENT OF AGRICULTURE
FARMERS HOME ADMINISTRATION
FINANCE OFFICE

REPORT CODE 205C
PAGE NUMBER 10

1280222
FARM OPERATING LOANS

STATUS OF LOAN AND GRANT OBLIGATIONS/ALLOTMENTS OR DISTRIBUTION
FISCAL YEAR 1986 AS OF 04/09/86
(IN TENS OF DOLLARS)

		CUMULATIVE						
	DISTRIBUTION	NO OF LOANS	INITIAL OBLIGATIONS	NO OF LOANS	SUBSEQUENT OBLIGATIONS	TOTAL LOANS	TOTAL OBLIGATIONS	UNOBLIGATED DISTRIBUTION
PENNSYLVANIA								
REGULAR		12	434.15	35	1,005.74	47	1,439.89	
YOUTH		7	10.86	1	4.30	8	15.16	
TOTAL	7,480.00	19	445.01	36	1,010.04	55	1,455.05	6,024.95
LIMITED RESOURCE		72	3,720.67	335	6,327.43	407	10,048.10	
TOTAL	11,221.00	72	3,720.67	335	6,327.43	407	10,048.10	1,172.90
TOTAL INSURED LOANS	18,701.00	91	4,165.68	371	7,337.47	462	11,503.15	7,197.85
GUARANTEED FARM OPERATING LOANS								
REGULAR		6	450.97	4	257.00	10	707.97	
TOTAL GUARANTEED LOANS	34,194.00	6	450.97	4	257.00	10	707.97	33,486.03
RHODE ISLAND								
TOTAL	261.60							261.60
LIMITED RESOURCE		2	63.20	2	62.59	4	125.79	
TOTAL	392.40	2	63.20	2	62.59	4	125.79	266.61
TOTAL INSURED LOANS	654.00	2	63.20	2	62.59	4	125.79	528.21
GUARANTEED FARM OPERATING LOANS								
TOTAL GUARANTEED LOANS	2,508.00							2,508.00
SOUTH CAROLINA								
REGULAR		85	4,314.01	92	4,559.28	177	8,873.29	
TOTAL	9,182.10	85	4,314.01	92	4,559.28	177	8,873.29	308.81
LIMITED RESOURCE		78	4,875.78	183	10,323.78	261	15,199.56	
TOTAL	17,887.04	78	4,875.78	183	10,323.78	261	15,199.56	2,687.48
TOTAL INSURED LOANS	27,069.14	163	9,189.79	275	14,883.06	438	24,072.85	2,996.29
GUARANTEED FARM OPERATING LOANS								
REGULAR		40	3,119.79	7	624.54	47	3,744.33	
LINE OF CREDIT		1	107.00			1	107.00	
TOTAL GUARANTEED LOANS	16,767.00	41	3,226.79	7	624.54	48	3,851.33	12,915.67
SOUTH DAKOTA								
REGULAR		101	2,584.59	187	3,692.11	288	6,276.70	
YOUTH		1	5.80			1	5.80	
TOTAL	10,065.60	102	2,590.39	187	3,692.11	289	6,282.50	3,783.10
LIMITED RESOURCE		150	5,606.24	745	15,720.38	895	21,326.62	
TOTAL	22,599.40	150	5,606.24	745	15,720.38	895	21,326.62	1,272.78
TOTAL INSURED LOANS	32,665.00	252	8,196.63	932	19,412.49	1,184	27,609.12	5,055.88
GUARANTEED FARM OPERATING LOANS								
REGULAR		141	14,864.64	30	2,250.11	171	17,114.75	
DEBT ADJUSTED		9	1,437.00	1	85.50	10	1,522.50	
LINE OF CREDIT		26	2,138.42	20	1,295.30	46	3,433.72	
TOTAL GUARANTEED LOANS	33,868.00	176	18,440.06	51	3,630.91	227	22,070.97	11,797.03

as of 4/16/86 256 24,786,59

Mr. Clark. I am sorry. Did I miss a question or are you through?

Mr. Daschle. My time has expired.

Mr. Stenholm. Mr. Gunderson.

Mr. Gunderson. Thank you, Mr. Chairman.

I would be interested in asking our other three gentlemen a question and give Mr. Clark a breather for a second.

A general comment made this morning consistently through the testimony when we asked how they would respond to the decisions that had been made by the FDIC, the Comptroller of the Currency, et cetera, regarding forbearance of capital, FASB 15, et cetera, they are concerned whether or not this is going to be carried out. They said if all of this is implemented with the regulators out in the field that it will be very, very helpful. They indicated that there is no such evidence to date.

I would be interested if any of you could comment and assure the subcommittee of what steps you have taken to carry this message out to your inspectors, your regulators in the field, and to make sure that what you have done here at the Federal level in regulation actually does occur.

Mr. Downey. I would start off by saying on Good Friday—it may have been a week ago Friday—we worked on about a 47-page circular with attachments that was printed and is being sent to 4,900 banks. I believe that has been in the mail. On Easter Monday we telecommunicated to our district offices that same package.

We have mailed to our 2,000-plus examiners that same package. So, we have distributed the whole program of capital forbearance, FASB 15, and what have you. And it is organizationally with each of us in the senior management in the Comptroller's office, to carry out that program.

Mr. Gunderson. Have there been any kind of training sessions with your regulators to make sure that this does occur, when they go out there from one bank to another?

Mr. Downey. The major part of the program is capital forbearance. Capital forbearance is a program which will probably be between our field and district offices and the banks, as it has been even before capital forbearance. The bank would come in to discuss their capital position, where they are going, and what have you; and that plan would be approved. That could happen tomorrow. FASB 15, we sent out a circular 1 year ago. FASB 15 has been there since June 1977. Most of our examiners are familiar with it except maybe some of the recently hired examiners may not be. So, there's no need for additional training there, but it continues to be a part of our regular training program.

Mr. Gunderson. Mr. Meadows, can you comment at all on this?

Mr. Meadows. We mailed information to both our regional offices, which will be distributed to field examiners, as well as each State nonmember bank on March 27. With respect to capital forbearance, banks which think that they may qualify for the forbearance need only to apply to the regional office.

We have also sent out material on FASB 15. We don't feel that we need training sessions at the present time. But if we detect a need, we will have those sessions.

Mr. Gunderson. Am I correct that all three of you oppose loan loss amortization?

Mr. **Meadows**. That is the FDIC's position, yes.

Mr. **Downey**. Yes.

Mr. **Taylor**. Yes.

Mr. **Gunderson**. Mr. Clark, can you give us a quick summary of the exact numbers? I heard your testimony but I don't recall that you said exactly how many dollars in operating and guaranteed loans, or direct and guaranteed operating loans are authorized and have been distributed at this point in time. In other words, what percent of the money for crop year 1986 is out there in terms of actually in the hands of a guaranteed loan or a direct loan?

Mr. **Clark**. In our direct operating loan for the fiscal year, we have obligated $1.6 billion. About 73 percent of our $2.2 billion funds for direct operating loans have now been booked. You recall we had the $700 million that was transferred under the President's authorization, from our emergency loan fundings into the direct OL Program. Of that $700 million we have $337.7 million yet to be allocated to those States.

Again, we have to be very careful about that. There are indeed some emergencies most likely that will happen in this country. We need, I think, to be very cautious of preserving what emergency funds we have yet available.

Mr. **Gunderson**. Just a second, a clarification. In the direct loans you had $1.6 billion or $2.2 billion authorized?

Mr. **Clark**. $2.2 billion authorized. It includes the $700 million.

Mr. **Gunderson**. That includes the $700 million.

Mr. **Clark**. It does, it does.

Mr. **Gunderson**. OK. Out of the $1.6 billion originally authorized under direct loan, 73 percent of that has been obligated——

Mr. **Clark**. No; 73 percent of our whole funding program. We have pumped the $700 million in there as well.

Mr. **Gunderson**. Of the $2.2 billion.

Mr. **Clark**. That's correct.

Mr. **Gunderson**. OK. So, you got $1.6 and $700 million, and we got $337 million yet to go, in direct loans.

Mr. **Clark**. Of the $700 million, yes. Of the whole total we have about $600 million left.

Mr. **Gunderson**. OK. This is why I am asking the question. You got $337 million left to obligate under the $700 million.

Mr. **Clark**. That's correct.

Mr. **Gunderson**. And you've got about $260 million left of the original $1.6?

Mr. **Clark**. That's right.

Mr. **Gunderson**. That gives us a total of about $600 million yet to go.

Mr. **Clark**. That's correct.

Mr. **Gunderson**. How about in the guaranteed area?

Mr. **Clark**. In the guaranteed operating loans, original allocation funding a billion seven. We booked about 30 percent of those loans, $505 million. We got a billion two yet to utilize. A lot of room.

Mr. **Gunderson**. All right.

Thank you, Mr. Clark, and thank you, Mr. Chairman.

Mr. **Glickman** [acting chairman]. Thank you, Mr. Gunderson.

Mr. Stenholm, have you asked questions yet?

Mr. Stenholm. Mr. Taylor, Mr. Meadows, and Mr. Downey, my question goes to the three of you. I followed your testimony. I followed the previous testimony before the Banking Committee in which you talk about the proposed change in regulations, the easing up in some cases to make it more possible for agricultural banks to weather this storm, and agree with most if not all of the suggestions.

My concern is that, just as we have heard time and time again today whether we're talking about Farmers Home or whether we're talking about anything that is happening in regard to the farm program, that we're saying one thing in Washington but it's not getting down to the grassroots level. Within the last 30 days, I had a circumstance with a small rural bank in my district in which they had an examination. They had three loans classified. They were agricultural loans that had had interest only paid for the past 2 or 3 years, interest only. They were classified. As the individual banker brought those individual farmers in to his bank and said, I got a little problem, we're going to have to work something out, all three of them sat down and wrote out a check for their loan, on another bank.

Now, I assume this was before the word has gone out on the change in this capital requirements, et cetera. But it is not so much a specific question to you as the fact that we continue to hear from the banking—I do, from my district—from the banking level, not wanting to say ease up too much, in a substantial amount of agreement with your testimony before this subcommittee today about some of the proposals that we are making and saying, let's not go too far, because it'll get us in trouble, too, while at the same time, expressing concern that the examiners who come to that bank do not have a fundamental understanding of agriculture and do not have a fundamental understanding of banking and are not in fact doing that which you have testified today, saying that that's the new look in examination.

Mr. Meadows. I'll be glad to start the response to that. It is difficult for us to know the full circumstances. First of all, I would say, if the banker only had three classified loans, he did not have a very significant problem. There is no——

Mr. Stenholm. You don't know the circumstances in this particular circuit, but go ahead.

Mr. Meadows. All right.

There is no requirement, in other words, the FDIC examiners, or the others, as far as that goes, do not require collection efforts on the part of the bank. That is up to the banker. Now, it could be in a situation like that full and complete information was not in the bank files. Maybe the banker didn't know that the loans could be paid in that fashion.

Obviously, in retrospect the loans should not have been classified. But what we don't know is, did the banker and did the examiner have full and complete information about that particular borrower?

Mr. Stenholm. in all candor, the banker admitted to me that it quite possibly was a personality clash because of his personal opinion of the examiner who was in the bank. And he accepted his share of the blame of some of the things that occurred because of the manner in which he personally felt about this particular examiner.

Also, the circumstances around this particular loan were that he owns another about five banks besides this one and has just put $2 million of additional capital into all of his ag banks, trying to keep them up. So, while it may just be three at this one bank, it was a little more serious to that individual banker.

Your comments are well taken and appreciated.

Are there any other comments? What are you doing to see that in fact the message that you bring to us is in fact getting down to the examination level?

Mr. TAYLOR. If I could just respond, you know, we have an admitted difficulty and an unevenness among training and expertise in people. We try to even that out as well as we can with training. But I would point out that, with respect to the agricultural banks, in addition to delivering the messages as clearly and as completely as possible, which we will do again next week at a meeting of all of our regional vice presidents, we have set in place a procedure whereby each agricultural bank draft examination report is reviewed by an officer or a senior person at our district bank before it is returned to the banker. That examination report is reviewed to tighten up the consistency and to make sure that the programs that we are putting in place are indeed not being frustrated by the miscommunication or the lack of experience of a new examiner.

That has worked pretty well. We continue to have a miss now and then, but we continue to operate that program.

Mr. DOWNEY. We have a similar program, but I want to speak to what we have just put out. We have the same concerns. Your points are well taken. We do have some examiners out there that may be a little bit overaggressive sometimes. We do follow up on every one of those situations that are brought to our attention.

As far as the capital forbearance program goes, the OCC has put into place a monitoring system so that every bank that approaches our office regarding capital forbearance, in the event that they are turned down, that denial will come into the Washington office subject to my review, so that it will have an additional review. We don't want to put into place a capital forbearance program and then not have it implemented in the various districts. So, we have put that into place.

I might also say, in defense of the examiners, that it is getting to be a very difficult job being an examiner out there where our problems are the greatest that they have ever been. It is getting difficult to hold on to good examiners. We do have a newness to some of our people. We are working very diligently to try to get them up to snuff like the rest of us.

Mr. TAYLOR. They're getting old fast, I might add.

Mr. STENHOLM. Thank you. My time has expired. I have some additional questions. I will wait for my other colleagues.

Mr. GLICKMAN. Mr. Evans.

Mr. EVANS of Iowa. Thank you, Mr. Chairman.

I would like to begin by visiting a moment here with Mr. Clark and to say I have the greatest respect for the efforts you have made to get control of the management of that agency to which you're saddled and say to you that I think that in the State of Iowa at the State level things are functioning very, very well.

I would go on, however, to speak for a minute or two in more general terms on this problem of consistency of policy. I don't think there is any question that there is inconsistency of policy at the various levels of bureaucracy within the Farmers Home Administration. I think that in our State it happens to be at the country level rather than departures at the country level from the philosophy that you are proposing and the policies that you are proposing rather than at the State level.

There is absolutely no doubt in my mind that there is within your bureaucracy a very substantial number of people at all levels who have absolutely no time for the guaranteed program and who make no bones about it and have every desire to do everything they can to slow that down and go back to direct loans. They think that's the way it ought to operate in the Farmers Home Administration. I know you are trying very hard to overcome this.

My question to you is, Is it possible to overcome this? Do you have the powers available to you to take action against those people who deliberately not following the policy set forth at the national level by Farmers Home?

Mr. CLARK. Well, I've got to tell you. The transition from the private sector has been difficult for me. In my other life, I could fire people and that would be the end of it. I can't do that in civil service, I have learned. There are all kinds of appeal processes, Merit Protection Boards, and I really can't crack that whip as I did in my other life. It is frustrating. It's hard to get 12,000 people marching down the same road, let alone at the same beat. We have terrific training programs going. Even 46 State directors marching to the same beat is very difficult.

I wish I could share with you some of the browbeating problems that we have gone through, just this morning, actually threatening my State directors, you know: if you don't lower this rate of approving loans without cash-flow, I have no alternative but to share that concern and disappointment with their legislators. So, I am looking to you to help me, if you will, to crack some of those whips. It's very difficult.

Mr. EVANS of Iowa. I understand that. I appreciate that very well. The only suggestion that I have, and I offer it only partially in jest: do you think it might be useful if we authorized and directed you to open a branch office in Nome, AK, with unlimited size of staff and the ability to transfer people to that office?

Mr. CLARK. That's a fine idea.

Mr. EVANS of Iowa. If I may leave that and go to the other three representatives of the regulatory agencies of the commercial banking system, there have been implemented a number of changes recently. They have been alluded to here, to make it easier for the commercial ag banks to handle their problems and to encourage them to restructure debts, and so forth. Some of those things were discussed, or variations thereof, when we were looking at Farm Credit System legislation here in the latter part of last year. At that point Treasury, for example, was not nearly as receptive to some changes of this type as they have become since the first of the year.

Do you as regulators of the commercial banking industry have any objection to trying to give those same sort of powers and flexibility now to the elements of the Farm Credit System? Do you think they have the power to do that under present law through the FCA, or does that require legislation on our part? Or are there any other comments you have on that, the apparent difference that now exists to some extent between the flexibility of commercial agricultural banks and the Farm Credit System?

You don't have any objection then to extending the same powers to the Farm Credit System, one way or the other?

Mr. TAYLOR. Do you mean to extend the powers to the FARM CREDIT SYSTEM to deal with lower capital?

Mr. EVANS of Iowa. They have that. I think we gave them that. We didn't give them some of the other things, however.

Mr. TAYLOR. The FASB 15.

Mr. EVANS of Iowa. Yes.

Mr. TAYLOR. Well, I think that, from the comments that Mr. Clark has made, that the concept of FASB 15 wouldn't be foreign to them. It sounds to me like to the extent that a loan provides cash-flow———

Mr. EVANS of Iowa. Well, we're not talking about Farmers Home now; we're talking about the Farm Credit System.

Mr. TAYLOR. I would think that the Farm Credit System would not be averse to reschedulings or whatever was needed if indeed the loan provided cash flow over a reasonable period of time to repay the loan.

Mr. EVANS of Iowa. But you don't have any objection to their having comparable power?

Mr. TAYLOR. I would not think so.

Mr. MEADOWS. I don't know on what basis we would have to object.

Mr. CLARK. Could I make a suggestion? Give them more power. It will take a little heat off of me.

Mr. EVANS of Iowa. Mr. Chairman, may I have another minute?

Mr. GLICKMAN. The gentleman is recognized for 1 additional minute.

Mr. EVANS of Iowa. Again to the three regulators of the commercial banks. The point has been made by a number of bankers and representatives of the industry that there is a great need for a secondary market, a guaranteed secondary market of long-term agricultural debt to the commercial agricultural banks, guaranteed in some manner by the Federal Government in somewhat the same manner as we guarantee and market on the secondary market residential housing debt.

What observations do you have on the desirability of one way or another providing that kind of a secondary market capability to agricultural banks on sound agricultural loans at this point in time?

Mr. DOWNEY. Speaking for the Comptroller's office, the Comptroller's office is very much in favor of that. Mr. Clark has spoken to that in public hearings. One of the things we are looking at is ways in which we can help agricultural banks diversify their portfolios. One of the ways in which that would occur is through a secondary market for their ag loans.

Mr. EVANS of Iowa. Thank you, Mr. Chairman.

Mr. **Glickman**. Thank you.

Mr. Stallings.

Mr. **Stallings**. Thank you, Mr. Chairman.

I was interested in Congressman Daschle's comments on the number of loans in South Dakota. I am not sure if you are aware, but in Idaho we have had 24 guaranteed loans this last year, which does not speak very well for that particular program.

Mr. Clark, I really hate to heap additional criticism on your shoulders today. But having problems with the Farmers Home county supervisors and State directors is not unique to Missouri. I have received petitions from nearly 400 farmers in my State who are demanding the resignation of the Idaho State director. Are you aware of those petitions? What, if anything, has been done to investigate that problem?

Mr. **Clark**. My only awareness is from the news media, which have called me about it. I have not seen that in any form at all. I am waiting to be prodded with that. So, I am standing by.

Mr. **Stallings**. Very good. Thank you.

When you appeared before this subcommittee on February 6, I asked you about the status of the new regulations defining the family farm for purposes of borrowing from Farmers Home and for qualifying for disaster loans. You said at that time that these regulations were still being reworked. We are 2 months later down the road. Most of the disaster loan applications are still on hold in my State.

Again, what progress has been made in issuing new family farm regulations? Specifically, what have you thought of the guidelines that I submitted on February 12 for defining a family farm, in my opinion, that I think would be very equitable to both farmers and American taxpayers?

Mr. **Clark**. Again, those regulations are imminent. They should be out very, very soon. In fact, we have letters in preparation to all the committee members saying: Here's what we have in mind; it's going to interim rule, going out for comments as well; what do you think about it?

One of the major benchmarks in that proposed family definition in addition to blood or marriage relationship, in addition to blood or members of families getting together with entities that are eligible for coverage is a limit of gross farm income. We are proposing $500,000 as gross farm income. We are going to ask you about that. That is one of the big benchmarks. I think yours was higher than that, as I recall.

Mr. **Stallings**. Yes; it was.

Mr. **Clark**. $750,000?

Mr. **Stallings**. I was asking $750,000. I think that's imperative for the western farmers.

You said in your testimony that you think that new Farmers Home interest rate Buydown and Loan Guarantee Programs are sufficient to meet the credit needs during fiscal year 1986. Is this situation really true everywhere in the country, particularly in States like Idaho, which have made very few guaranteed loans? As I said, there were only 24 so far in the State. I guess you wouldn't need much money if we're only going to make 24 or 25 loans per State.

Mr. CLARK. No; we wouldn't.

We will probably use those funds from your State by reallocating to another State that has greater demand for guaranteed funds.

I have to tell you. It's going to be a close, tight, squeaky call this year to get through with what we've got. But we need the cooperation of the other lenders. We can't do it alone. In some States we are the primary lender. Fifty-five percent of the credits booked in Louisiana are Farmers Home. That's ridiculous. We cannot go on that way. We need the help of the other lenders, and in your State as well. I ask for your help in that direction.

Mr. STALLINGS. Thank you.

Mr. GLICKMAN. Thank you.

Mr. Franklin.

Mr. FRANKLIN. Thank you, Mr. Glickman.

Mr. Clark, I am going to direct my questions to you and point out to you that in my district 65 percent of the credit penetration is with you and your agency.

I want to sincerely thank you for the efforts on Mississippi's behalf in trying to put some pressure on getting these loans out. You know firsthand about it because we have had a credit team. We have had a homestead team. We've had every team that you can imagine go down there from your office. I thank you for that and for your cooperation.

However, that was yesterday. Today I understand that there are $11 million worth of loans sitting there waiting for you to let go today. Did you sign that today, that additional $11 million that we've got up there?

Mr. CLARK. It's $9.9 million, and I did not. I've got some questions about your fair State that I need to talk to that director about. That is, again, approving almost 10 percent of the loans that don't cash-flow. I need a better "scout's-honor" that's not going to happen anymore. So, that's really what we're negotiating with your State director about.

Mr. FRANKLIN. I understand that, but I want you to realize that the negotiations with the State director are causing severe problems for the particular farmer who does happen to qualify and has been through the process and whose loan is sitting on your desk during a negotiating process with the State director who meets all the requirements and who just got a rain and who needs to plant that cotton tomorrow in Mississippi. And he can't do it without that money that you've got held up on your desk.

The second thing I want to ask you about is this. When can we expect the homestead regulations providing those farmers who are not being financed this year in my district to come in, have their land surveyed, keep their house, finance for 35 years on a separate note, and have at least a place to live, coupled with the debt settlement regulations? When can we expect those regulations to be promulgated and in the field and working, sir?

Mr. CLARK. I wish I could give you a date. I can't. But I will tell you that it's very immiment. We are looking for a publication date within the next 2 weeks. But the regulations are in the field on the homestead provision. We are taking applications, especially in your State. We did a good intensive study of that: get in line; here's the application; when it's ready, we'll do it with you.

Obviously, some of that property is going to stay there as it is. We are not going to disturb those tenants. We're not going to file foreclosures on them while all of this is happening. So, I think they can be pretty confident about keeping the kids in school and staying there.

We are going to be ready to sign them up when that debt settlement regulation is published.

Mr. **Franklin**. Then I can assure those farmers who happen to be in that particular situation and who are waiting with baited breath the regulations, that in the interim adverse action is not going to be taken, and they will be given a chance to make application for the homestead provisions and for the debt settlement?

Mr. **Clark**. Well, now you're pinning me to the wall.

We have some dishonest borrowers, even in Mississippi. We've got to be careful about that, you know. The dishonest ones, we might have a problem with. But of those farmers who have worked, and through no fault of their own, are really having a failure, we're ready to offer them that opportunity. So, I would say yes.

Mr. **Franklin**. In the normal case then, in 1986, they can have some assurance that those regulations will be in place, and in the interim that no adverse action will be taken as far as foreclosure is concerned?

Mr. **Clark**. Well, part of that is the debt settlement. They either have to agree—you know, here are the keys to the gate; we give up; take my land; leave me the house. We can do that. If they are not cooperative and won't do it, we do have to go through the foreclosure proceedings.

Mr. **Franklin**. As I think you understand, we have got several that are already standing in line to hand you those keys in Mississippi.

Mr. **Clark**. We'll do it.

Mr. **Franklin**. The second question: In the debt settlement regulations—and I know that you're negotiating on those now—are you aware that—I am sure you are—that the State only has a $25,000 limit——

Mr. **Clark**. I am.

Mr. **Franklin**. On what they can do without having to burden you with the problem? It would appear to me that, if you increase that limit, that you could give the State director somewhere substantially more than that, that it would save a whole lot of time in going through this process? Have you considered that? Do you have a figure in your mind as to what that State director ought to have as far as authority and debt settlement is concerned?

Mr. **Clark**. My starting figure is $100,000, Mr. Franklin. So, we are going to get the authority out there to do that.

Mr. **Franklin**. Could I double you and ask you to consider it?

Mr. **Clark**. Sure.

Mr. **Franklin**. I think that it's going to take more than that for you not to get all the ones that are applying in my district, is what I am saying to you. And then you'll be burdened with it rather than let this go on and take place through the State where they can also do it.

Again, I want to thank you for yesterday's efforts. However, the problems still continue today. We want to continue to be able to rely on you to help us solve those problems in Mississippi with Farmers Home.

Thank you, Mr. Chairman.

Mr. **Glickman**. I would just like to ask Mr. Downey and Mr. Meadows this. Some of the folks in my home believe that you did not take the kind of reasonable action that you are currently taking with respect to a variety of banking flexibility on capitalization and amortization of loans until the energy crisis began to hit. That is, the ag crisis was real for a long time, but that didn't seem to be enough. It took the added hit of energy problems in the central, southern, and southwest region of the country to get you to become more flexible.

I wonder if you might comment on that.

Mr. **Downey**. I think, Mr. Chairman, if I could, we spent the latter half of last year dealing with national banks that represent 5 percent of the assets. As the Chief Examiner for the country, I spent 50 percent of my time in agricultural matters. So, there has been that concern. We work very closely with a lot of groups of people. We have traveled the country trying to really get our hands on what the problem was. We determined it was capital forbearance, and we worked with it.

When we went before the Senate Banking Committee, our proposal was strictly to agricultural banks. By the time that hearing was over, it had included energy. So, I think our efforts were directed at agriculture. We were moving to provide some assistance to those banks. Energy was something that came later. So, I don't think there is a correlation. Energy did not force this.

Mr. **Glickman**. Mr. Meadows.

Mr. **Meadows**. I fully concur with Mr. Downey. Like Mr. Downey, I spend a great deal of my time dealing with the agricultural situation. I think the fact is that most agricultural banks have been very well capitalized over the years. They have now in the past year gotten to the point where that capital is being called upon to absorb losses and, as a result, the Capital Forbearance Program.

Mr. **Glickman**. My second question relates to the legislation which we have before us, the Panetta bill and the Bedell bill. I think you have spoken to that to some degree in your testimony. I wonder if all three of you, Mr. Meadows, Mr. Taylor, and Mr. Downey, would indicate how you feel about that proposed legislation or any other that would deal with credit forbearance and/or banking regulation changes that would require that kind of forbearance or different accounting treatment of bank assets.

Mr. **Meadows**. As expressed in our testimony, we have very serious reservations about any program that would delay recognition of losses. We have some very serious problems with that. We think that losses should be recognized currently. We think it is unreasonable for the banking industry to, in effect, put off their problems to the future. We think it would be much better for the banks to put their problems behind them.

We think the program that we have with capital forbearance will allow them to do that and still give the public, the investors, and depositors a balance sheet or a published statement that can be relied upon as being accurate.

Mr. GLICKMAN. Mr. Downey.

Mr. DOWNEY. We believe that the program in place does not require any additional legislation or laws that we would need at this point in time. We have a plan which, as we explained, capital forbearance, extending the lending limits, and FASB 15. I don't think that requires any legislation.

Mr. GLICKMAN. Mr. Taylor.

Mr. TAYLOR. I don't believe that we would resist any legislation that incorporated in the basic meaning of what we have tried to propose on a voluntary basis. But legislation that would defer losses, I think, brings up the problems of nonrecognition of the reality of the situation, and indeed could exacerbate the Government's cost as well as the farmer and the banker's problems.

Mr. GLICKMAN. The only thing I would respond to you is that it took an awful lot of congressional pressure and threat of legislative action to get you to move in these areas. I want the record to reflect that I think it was the fact that lots of folks were coming up here to Capitol Hill to say these regulators are not being very responsible in how they're treating losses; they're being too black and white, cut and dried, without reflecting the realities of what was going on there for you to even come up with what you were doing. So, there is, at least on some of us, a little bit of skepticism about where you were coming from during all this time.

Whether we pass any legislation or not, we're still going to keep the pressure on you to reflect responsibly on how you deal with the rural banking situation.

I would ask for 1 additional minute.

I just think that's very important because the energy situation is causing a doubling of the problem.

Two quick things: the secondary market issue that Mr. Evans talked about, how would you feel about setting up a Fannie Mae or a Ginnie Mae type of entity for Government-backed securities in the agricultural market, either Farmers Home securities or other kinds of securities? Some people say that is what we need to establish some liquidity in the markets.

Mr. TAYLOR. The questions of cost aside, I think that it would be a good idea, but I do think you have to face the question of what it would cost to do this and what it means in the way of increased Government expenditures.

Mr. MEADOWS. I think one other aspect should be noted, too. I am not convinced that there is a nonavailability of funds to lend on the part of the commercial banks. The banks seem to have funds to lend and do not appear to be under undue pressures from the standpoint of liquidity. But such a proposal could work very well.

Mr. GLICKMAN. It would be a permanent type of entity to deal with this at all periods of time, which has worked very well in the housing market and the Government securities market. I just think that we have never really seriously considered that recently, at least in the ag market.

One final question I would ask Mr. Downey and Mr. Meadows particularly. How many rural banks are we going to have fail this year?

Mr. MEADOWS. Mr. Chairman, so far this year, there have been 13 so-called agricultural banks which have failed. This is exactly the same number that had failed at this time last year. At this point we don't know what effect the new programs will have on bank failures, but we feel that there still will be a sizable number, perhaps very close to the same number we had last year.

Mr. GLICKMAN. Mr. Downey.

Mr. DOWNEY. We had 30 national banks fail last year. We had eight fail in the first quarter. Annualized, that would be 32. I think the number of banks that will fail, national banks, will probably be a little bit greater than it was last year, somewhere in the thirties. Of course, most of those will be small rural banks.

Mr. GLICKMAN. Will they be banks with a lot of energy loans?

Mr. DOWNEY. I think they will be a combination of energy loans, ag loans, and what have you. It seems like the eastern part of the country seems to be in pretty sound condition. I think where our problems are are, as you well know, in the Midwest and Southwest.

Mr. GLICKMAN. Thank you very much.

Mr. Stenholm.

Mr. STENHOLM. Mr. Clark, I haven't asked you yet today, so I want to ask today the situation concerning the dispensation of the additional $600 million in direct loans and the $337 million and the extra $700 million that was transferred regarding in this case the State of Texas, which I am told has $18 million in approved loans awaiting the cash dispensation from this fund. Farmers are ready to plant. What really got my attention was my Small Business Subcommittee holding hearings last week and many of the small businesses that have been selling them, advancing them fuel, fertilizer, et cetera, are beginning to get nervous, too, now about when they might be expected to receive those funds.

Mr. CLARK. That's correct. There is $18 million in the pipe in Texas. I might tell you that, if we had allocated that $700 million to every State, as we do original allocations, you would be overdrawn. Texas has now drawn more than their share from that $700 million reserve.

We are looking at it. Again, I have some problems in Texas with the approval of loans that don't cash-flow. I have a conference call, once I leave here, with the State director about that problem.

We have been doing very well, I think, by Texas. We have got $174 million down there. We started out originally at 118 allocations. So, I think we have done very well by Texas.

I hear what you're saying. It's planting time. Those cotton growers are out there ready to go in many parts of the State. We will do the best we can.

Mr. STENHOLM. I appreciate that. I guess the problem that we have now is the farmer awaiting his funds who can cash-flow is not going to have much sympathy on you or me or anybody else for having advanced money to a farmer who cannot cash-flow. I guess that's hindsight and can't do anything about it.

We will appreciate a speedy handling all over the United States of those farmers who can cash-flow, who do qualify, where we do have the money set aside, getting the money to them. It's planting time.

Mr. CLARK. That's exactly my point. We need to be sure that State is putting forward to be funded those loans that should be funded.

Mr. **Stenholm**. What States have the most problems with State banking regulations that create problems that some folks are suggesting that we solve federally but yet we have the State problems? I forget which one, Mr. Meadows, Mr. Taylor, Mr. Downey, referred to that in your testimony, saying that there need to be some changes in State regulations. What are some of the States that have got some problems that are making it difficult for us to even consider doing something federally?

Mr. **Meadows**. I think I had comments in my testimony concerning that States should take a look at laws and make appropriate changes. What we were referring to there—and it's going to be very difficult for me to name the States, because I just don't have them handy. There are a number of States which have very restrictive branching laws, which make it very difficult if not impossible for the FDIC to find a buyer in the event of a failure. As a result, we may end up with a deposit payoff as opposed to a merger which would continue banking services in a particular community.

Mr. **Stenholm**. If I might interrupt you at that point, without naming States then, in those States where there is a problem, is the legislative climate within the State now to where they are looking at it? Or are the original reasons for having the law in the first place still the prevalent political attitude within that State?

Mr. **Meadows**. It's my understanding that a number of States are looking at it, although with varying degrees of success in resolving the problem.

Mr. **Stenholm**. There is not a unanimous agreement on what ought to be done?

Mr. **Meadows**. Absolutely not.

There are other areas that do present problems, too. For an example, some States require other real estate, real estate acquired through foreclosure, to be written off over a period of time. In other words, the bank might be required to write off 20 percent of the book value of that real estate each year. We think States should take a look at laws like that. Our position is that banks should be permitted to carry real estate in that fashion at appraised value rather at some charged-off amount.

I think the OCC may have liberalized their regulations in that area recently.

Those are some of the things. There are other laws which prohibit corporate ownership of farms. That might limit the marketability of farms and hurt the entry into the farming business and the exit from the farming business. People might like to get out, but there's nobody to buy.

Mr. **Stenholm**. Thank you, Mr. Chairman.

Mr. **Jones** of Tennessee. Thank you very much, Mr. Stenholm. Mr. Evans, do you have questions?

Mr. **Evans** of Iowa. I do, if I may, but I would be glad to——

Mr. **Jones** of Tennessee. I want you to go ahead.

I just want to apologize to the witnesses for my having been absent. I had something else that had to be done, and we had someone else here who could do this.

You are recognized.

Mr. **Evans** of Iowa. Thank you very much.

I would like to speak to the three gentlemen again from the regulatory agencies. I hope you have come to understand today that there is very little connection between the rates that are charged to extremely creditworthy borrowers for short-term operating loans out there in the country and the national rates that you people look at as indicators of what is happening to interest rates in the country as a whole. I very regularly get calls the last few weeks from outstanding borrowers from the standpoint of the ability of that person to repay. Farmers that owe nothing on their land, farmers who could cash-flow 150, 160, 170 percent of any operating loan, are saying: how come is it, with the prime rate at 9 percent and the discount rate at 7 percent I am having to pay 12 or 13 percent for farm operating loans?

I think it is very important to you people, who are looking at things from the national level, to understand that, when that prime rate comes down, you aren't seeing any results like that in the country for the foreseeable future. Now, there is a lag and there always has been a lag out in the country; and I understand that. But it's more than that. I think you need to understand it.

There are a lot of banks out there that have no problems at all that are charging those kinds of rates to the prime borrowers in agriculture.

To go on from that just a little bit further, it has been noted here today that many of the ag banks across the country are very reluctant to participate at all in any agricultural financing today and even under the guarantee program. That is a major problem that faces Mr. Clark in these programs.

My question to you is, what, if any, role is there or responsibility of your agencies to see that there are not abuses of that kind out there in the country that are causing great problems for agriculture and the recovery of agriculture? Do any of you care to comment on that?

Mr. DOWNEY. I would make a statement, Mr. Evans. One of the things we were proposing and have probably every time we have had an opportunity to appear before a subcommittee here is that competition solves a lot of those problems. When you have competition of other providers of financial services willing to go in and provide those rates which you are talking about to those worthy borrowers, that is when they are going to receive them. When you have artificial barriers set up where those people cannot grant those types of credits, then you will have this what you are calling probably a higher level.

The other thing is that, if you follow the interest rates on ag loans, they don't really correlate to the way the interst rates move in the other markets. When we had very, very high interest rates in this country, in most of the ag banks they did not go up in the same relationship as other banks charged the prime credits in urban areas. So, there is that.

Mr. EVANS of Iowa. I understand that. I would like to comment on your use of the word competition, however, if I may. There are reasons why competition isn't working out there at this point. One of those is that historically the Farm Credit System has provided some strong competition to commercial banks in getting their rates down, both on short-term operating loans and to the extent that banks are involved, which is a much lesser extent, in long-term real estate loans.

That competition does not exist today. The Farm Credit System Rescue Act that we passed recently, for the immediate future at least, and maybe for the long-term future, depending on what policy evolves in the Farm Credit System, condemns that Farm Credit System to be essentially noncompetitive compared to a lot of the commercial banks.

There is, if you will pardon the expression, to some extent a good-old-boys club within the banking industry and in the agricultural banking community. That is not unique to banks. I don't put it down there. It applies in many other industries as well. But it borders naturally, or tends to, on restraint of trade, if you will. There are an awful lot of people that are not responding competitively at this point because they are not forced to.

If I may go further, I think there are a lot of savings and loans in this country who would love to get in there and provide some of that competition. Generally speaking, they don't have the staff who are competent in lending to agriculture. I think there are a lot of insurance companies that would be delighted to get in there and provide some of that competition, if they had a retail network and the ability to do this, or a secondary market that would enable them to do this. I think it's terribly important if you want to see a recovery in agriculture, that some of these problems be addressed in one way or the other.

I would just point out to you a typical farmer's case in my district who raises corn, for example. It costs him something like 15 or 16 cents a bushel for the seed; something like 17 or 18 cents a bushel for the chemicals; maybe 25 cents a bushel for the fertilizer; maybe 10 cents a bushel for the fuel. But what's his cost of debt service at this point if he's got $1,000 an acre borrowed against that land? It's on the order of $1 a bushel. It overwhelms all other costs.

It is a terribly important element in how we get out of this mess in agriculture. I think that the regulatory agencies of the commercial banks need to look hard at the possibility of some unwarranted abuses. I don't know what you do about it, but I think you ought to be aware that, in my judgment, they are there and it ought to be addressed. Maybe it isn't within your power at this point to do so.

Thank you, Mr. Chairman.

Mr. JONES of Tennessee. Thank you very much, Mr. Evans.

Mr. Franklin, do you have questions?

Mr. FRANKLIN. No, Mr. Chairman.

Mr. JONES of Tennessee. I suppose that concludes all the questions except one.

I wanted to ask Vance Clark. I am sorry. I read your testimony but I was not here. Have you had an opportunity for your shop to make a cost estimate on H.R. 3868?

Mr. CLARK. Refresh my memory, the number again, Mr. Chairman?

Mr. JONES of Tennessee. It is H.R. 3868.

Mr. CLARK. That's the one we testified today?

Mr. JONES of Tennessee. Yes.

Mr. CLARK. No, we have not.

Mr. JONES of Tennessee. You have not?

Mr. CLARK. No.

Mr. JONES of Tennessee. Would you mind doing that? Can you do that and let us know your cost estimate before we take any further action?

Mr. CLARK. I will be happy to do that.

Mr. JONES of Tennessee. I appreciate it very much. I think we ought to know that before we start consideration of the bill.

Would you agree?

Mr. FRANKLIN. Yes.

[The information follows:]

We have learned that H.R. 3868 is considered a "dead bill" and no costs estimates are required.

Mr. JONES of Tennessee. If there are no further questions——

Mr. EICKHOFF. Sir, I have one. Can a farmer from Indiana say just a very short sentence?

Mr. JONES of Tennessee. Yes, sir.

If you will just wait a moment, we will take you as the next witness.

I want to thank you very much, gentlemen, for being here. I am sorry I missed your testimony. I will read it anyway. I am sure it will contribute greatly to this hearing. I hope what Mr. Evans said will be looked at in the final moments of his testimony there, just a few moments ago.

You are dismissed.

Now if the other gentleman will come forward.

STATEMENT OF NORMAN EICKHOFF, FARMER, CARTHAGE, IN

Mr. EICKHOFF. My name is Norman Eickhoff. I am a farmer from Rush County, IN, Carthage. What I have in mind, along with other people, is a good solution to the farm crisis. It should end it. The farmers, ranchers and growers of this great country have no say in what we get for what we produce. Everybody else can put a price tag on it; we can't. We have got to get that right, gentlemen, or we're done as family farms.

We would be happy to work with Congress, the administration. I have done several things along those lines. I won't take your time up now. We can save this country billions of dollars and bring prosperity to this country and to the rural areas you guys can't believe. And it will not hurt the American consumer.

We should have $5 corn, $12.40 beans, $7 wheat. And it wouldn't change the price of a loaf of bread or a box of corn flakes but a penny or two. We've got the overwhelming support of the American people. I know that because I have been traveling all over this country.

We are the new group that you should listen to.

Mr. JONES of Tennessee. Would you identify the group? Do you have a name?

Mr. EICKHOFF. Yes, sir, I sure will. I am proud of it. I am the State chairman of the Farmers, Ranchers, and Growers of Indiana. I am affiliated with the National Save the Family Farm Coalition that I helped put together out at Des Moines, IA. One hundred seventy-one groups from 34 States were represented. We are growing like wildfire because we have solutions to tough questions.

We would love to work with you. If we all work together, we can solve this crisis and save this country billions of dollars. It can be done, sir.

Mr. JONES of Tennessee. Let me say I regret that we did not have you or your group as a witness today.

We did our best to cover the waterfront.

Mr. EICKHOFF. I know you did.

Mr. JONES of Tennessee. We need help ourselves.

Mr. EICKHOFF. You guys got a heck of a job. I don't envy it.

If we all work together—do you know how many farm deaths or suicides that we know of in this country? Over 400, and we think it's just the tip of the iceberg. The farm crisis—family farmers divorcing. It used to be the most stable, the farm family, in the whole country. And now it's pathetic. I know in my own case the wife and I are having all kinds of troubles because, where's the money coming from? Are you sure we can stay in farming? We can if we get a price that we can live with.

I will be glad to go into details. In fact, I have with some of your staff. I have talked to them. In fact, I have talked so much, I can't really talk anymore. And for me, that's rough.

Mr. JONES of Tennessee. We appreciate you being here.

Mr. EICKHOFF. Thanks a lot.

Mr. JONES of Tennessee. We will be glad to hear from you further.

Mr. EICKHOFF. I appreciate you listening to a grassroots farmer. Thank you, gentlemen.

Mr. JONES of Tennessee. Thank you very much.

The subcommittee stands adjourned until the call of the Chair.

[Whereupon, at 4:25 p.m., the subcommittee was adjourned, subject to the call of the Chair.]

[Material submitted for inclusion in the record follows:]

STATEMENT OF

THE AMERICAN BANKERS ASSOCIATION

I am Mike E. Fitch, Vice President for Agribusiness Affairs with Wells Fargo Bank of San Francisco, California, and current Chairman of ABA's Agricultural Bankers Division. Accompanying me today is Bruce Meriwether, President of the First National Bank, Dubuque, Iowa, and President of the Iowa Bankers Association.

Mr. Chairman, I represent the second largest commercial bank lender to agriculture in the nation. For the past 3-4 years, West Coast farm borrowers have been facing the same cost price squeeze that is affecting the Midwest and other heavily agriculture-dependent areas. At Wells Fargo, the agriculture portfolio has traditionally out-performed other loans, However, for the last two years agricultural loans have not performed nearly as well as the rest of Wells Fargo's portfolio because the farmers are not doing well. According to the Federal Reserve Bank of Chicago, California banks charged off more than twice as high a percentage of their agricultural loans outstanding in 1984 than banks in any other state.

Mr. Chairman, we appreciate the opportunity to address the problems of commercial banks involved in agriculture. The performance of the farm economy impacts more banks than many people realize. Of some 14,000 commercial banks, we estimate that more than 6,000 banks are substantially involved in agricultural lending (more than 10% of their portfolios). In addition, commercial banks hold $47 billion in agricultural debt. The agricultural economy contributes over one-fifth of the U.S. GNP considering both the direct and indirect impact of the industry. Agriculture has been a significant creator of new real wealth year after year and it is a major contributor to our national balance of trade.

Concern about the deteriorating agricultural economy and its impact on banks, their borrowers and their communities led the American Bankers Association and the Independent Bankers Association of America to establish a Joint Task Force on Agricultural Credit. The 13 member Task Force includes representatives from a broad cross-section of the agricultural banking industry. Mr. Meriwether and I both serve on it.

The Task Force has recommended a plan of action involving three main elements: (1) bank capital, (2) agricultural borrowers' financial conditions, and (3) farm real estate values.

The Task Force was formed because American agriculture is undergoing massive change that threatens both banks and their farm borrowers if they are not given time to adjust. Let me briefly discuss the problems of agriculture and the banks that lend to farmers.

Mr. Chairman, before I discuss the condition of commercial banks involved in agriculture and our farm borrowers, I want to express our Association's appreciation for the interest and involvement of members of this committee in the agricultural banking situation. The introduction of H.R. 3868 and H.R. 4267 with the banking and borrower components emphasized the importance of addressing the concerns expressed by commercial bankers about the agriculture financial situation. The response by the banking regulators that I will discuss later has lessened the need for aspects of these bills, but it has not lessened our recognition of the importance of these legislative initiatives. We appreciate them, and we hope to continue working with you, Mr. Chairman, and the members of this subcommittee and the full committee as we all continue to address the serious problems in the financing of agriculture.

Condition of Agriculture and Lenders to Agriculture

The agricultural sector of our economy is undergoing a period of massive strain and adjustment. Farm business failures and farm lender closings during 1985 occurred at a rate not seen since the Great Depression.

The current conditions in the agricultural sector are a by-product of the booming decade of the 1970s. During the 1970s, domestic and foreign farm sales grew sharply, increasing farm revenues at an annual rate of 10.1 percent. Much of this growth was fueled by exports which increased from just $7.0 billion in 1970 to $41.0 billion in 1980--an annual rate of almost 20%. By 1980, exports made up 30% of total farm sales compared to less than 15% in 1970. Thus, the growth in income that occurred through much of the decade was highly dependent on the farmers' ability to preserve or increase their share of exports.

There was a widespread belief--by government and private analysts--that foreign demand for our agricultural products would continue to grow at a much higher rate than we would be able to supply. This perception arose from the belief that low income nations would find it difficult to provide their population with food. Thus, U.S. farmers would have an unlimited market for their products.

However, the increased demand and slowly adjusting supply that made the decade a good one were short-term aberrations from the long-term trend. The trend for most of the 20th Century has been declining real prices for food products. In the current cycle, the trend has been restored. Prices dropped as supply far outstripped demand worldwide.

The result of this sudden and massive change in world markets was an equally sudden drop in farm income and increase in agricultural credit problems.

The farm sector's economic condition has continuously deteriorated since 1981. Farm income measured in real terms has declined by over one-fourth, and the real value of farm assets has declined by nearly one-half. The net result has been an increase in real equity losses of approximately $211 billion over a four year period. Most of the losses in real equity are due to large declines in real estate values which fell from $780.2 billion in 1981 to $588.4 billion in 1985, a decline of 24.5 percent.

Farm debt is concentrated among less than 20 percent of the 2.2 million farmers in the U.S. Approximately 17 percent of all farmers are highly leveraged, with debt to asset ratios of over 40 percent. However, these farmers with debt to asset ratios in excess of 40 percent owe approximately 46 percent of the total farm debt. Given this high concentration of the farm debt and the unprecedented (post WWII) four year decline in land prices, we can expect unprecedented rates of farm failures in the absence of corrective policy actions to assist banks as they work with their farm borrowers.

As the agricultural economy goes through a period of adjustment, so are lenders to this key area of our economy.

Commercial banks hold a large portion of the agricultural debt. The Federal Reserve Board estimated that during 1985 commercial banks held $47 billion or 22 percent of the total. A large portion of this farm debt (80 percent) held by commercial banks is in the form of non-real estate debt for farm production loans. The commercial banking sector is the largest lender for farm production purposes.

These banks that lend to agriculture are under great stress. The 120 commercial bank failures in 1985 almost equaled the combined failures in 1983 and 1984, and the number of failures during the year was the most since the Great Depression. A recent report issued by the Federal Deposit Insurance Corporation concluded: "Agricultural bank failures took a sudden upturn during the second half of 1985. During the past 14 months farm banks accounted for just over 50 percent of all bank failures. Nonagricultural banks have been failing at about the same pace in 1985 as 1984, meaning that agricultural bank failures almost totally account for 1985's increased failure rate."

Table 1
Bank Failures by Type of Bank

	1982	1983	1984	1985
Agricultural banks	7	7	25	62
Other banks	27	38	53	56
Savings banks	8	3	1	2
Total	42	48	79	120

Delinquency rates on farm loans at all commercial banks have been increasing. Nationwide, in September 1985, 9.2 percent of farm production loans outstanding were classified as either non-performing loans (these are loans past due over 90 days and still accruing interest, past due in nonaccrual status, and renegotiated debt) or past due 30 - 89 days. This was a 42 percent increase from the level experienced during the same period in 1984 and up 119 percent from the same period in 1983. Much of the upward trend in delinquency rates consisted of increases in nonaccrual loans (loans on which neither principal nor interest are being paid) which grew from 3.8 percent in September 1984 to 5.6 percent in September 1985, an increase of 47 percent in a single year.

Farm production loans charged off by insured commercial banks totaled $900 million in 1984, up from $436 million the year before. In the first three quarters of 1985, charge-offs came to $755 million. This is 63 percent above the charge-offs experienced during the first three quarters of 1984. If this trend continues, the FDIC estimates that the total of such charge-offs at commercial banks may come close to $1.5 billion for the full year of 1985. It is likely that a large portion of these losses will be concentrated on banks in the western corn-belt and the great plains states where loan quality has deteriorated more rapidly.

The adjustment process in agriculture has weakened some farmers and contributed to the deterioration of agricultural banks. This certainly does not mean that large loan charge-offs at agricultural banks threaten the safety and soundness of the financial system. But the spiral of farm economic problems and bank failures are harming not farmers and bankers alone, but also the communities they serve. These farmers and banks and their surrounding communities can be expected to survive, but only if they are given more time to adjust to the massive changes now going on in agriculture.

Mr. Chairman, the ABA-IBAA Joint Task Force developed recommendations addressing three major aspects of the agricultural credit problem facing commercial banks and their borrowers: (a) bank capital, (b) borrowers' financial conditions, and (c) farm real estate values. These are the key areas that we believe must be addressed. However, we do not believe that we have identified the only means to address the problems in these areas. We are making proposals, but we are also willing to listen to any others. We want to work with this committee, the bank regulators, and any others to develop solutions to a very serious problem that is worsening.

I. Stabilization of Bank Capital

Banks are required by the bank regulators to maintain specific levels of capital. If a bank's capital falls below the minimum required by the regulatory agencies, the bank is subject to enforcement actions which may lead to closure.

Stabilizing bank capital is important because it is difficult for bankers to work with their farm borrowers to provide new credit for planting, restructure existing debt, or work out other solutions if the banks are in imminent danger of facing regulatory action because their level of primary capital drops below 5.5 percent. As stated earlier, the sudden change in the agricultural economy is resulting in great increases in agricultural loan charge-offs. Banks need time to absorb these losses so they can continue to work with their borrowers and remain of service to their communities. Sticking to a rigid rule on capital will not serve the public well in agricultural communities that need banking services.

Bank capital requirements are an important regulatory tool. In particular, they provide a buffer that helps protect deposit insurance fund reserves. In deciding the proper level of required capital for any bank, regulators must delicately balance these tradeoffs. Sometimes the level of capital to be striven for over the long run should be examined and adjusted due to circumstances. For agricultural banks, we believe now is such a time.

To keep agricultural banks open and to maintain their capacity to extend credit to borrowers, we recommend that special measures be implemented to stabilize the capital structure of agricultural banks. Agricultural banks traditionally have been well capitalized. However, the persistent downturn in the farm economy since 1981 has been severely pressuring the capital structure of hundreds of agricultural banks. Given time, the agriculture economy will recover, providing a basis for greater earnings and replenishment of the capital structure of agricultural banks. In the meantime, we need measures to prevent prudently managed banks' capital from being precipitously eroded with the resulting regulatory actions and, possibly, large numbers of closed banks.

Bank Regulators' Policy Announcements on Capital Forbearance

Mr. Chairman, we are pleased that in recent public announcements the banking regulators delineated a specific policy of direct capital forbearance. The Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation and the Federal Reserve Board all adopted a new policy permitting prudently managed banks experiencing difficulties because of the agriculture or energy economy to drop below the minimum capital requirement provided the bank has the capacity to restore capital within five years.

Mr. Chairman, while this announcement was only made on March 28, the reaction from bankers who are becoming aware of it is positive. We shall closely monitor its implementation to determine its effectiveness, but we are pleased by this policy change by the regulators. This recognition of the banks' capital situation in agricultural areas will help stabilize agricultural banks in the regions under the greatest impact from the deteriorating farm economy.

H.R. 4267 includes one provision directly relevant to this issue of bank capital levels. In Title III, H.R. 4267 would authorize the amortization of agricultural loan losses over a period of ten years. We appreciate the inclusion of this provision because amortization of loan losses was one of the options for stabilizing bank capital proposed by our Joint Task Force. However, the announcement by the bank regulators of their capital forbearance policy appears to achieve the same result--a reduction in regulatory pressure on bank capital levels and consequent negative impacts on borrowers. Therefore, we do not believe that legislation authorizing the amortization of loan losses is needed at this time. We do believe that the introduction of such legislation served as an important impetus for the regulatory action, and we appreciate the efforts of members of this committee to respond to the difficulties facing commercial banks that lend to agriculture.

Mr. Chairman, while outside the jurisdiction of this Subcommittee, there is a tax issue which should be mentioned because it also affects banks' ability to maintain capital levels adequate for the regulators. Under the current Internal Revenue Code, banks that experience a net operating loss may deduct that loss against income from their prior ten years of operation, and, if necessary, from their next five years. The House passed tax bill (H.R. 3838) would only permit banks to carry losses back three years, with fifteen years to carry them forward. For banks that experienced losses and had no income in earlier years, this change would be beneficial. Many banks, however, particularly in the Farm Belt, had income in earlier years but currently are experiencing heavy losses. The provision in present law allowing banks to look back ten years was designed to help cushion banks in this position. If this change were to become law, without even a phase-in period, agricultural banks with net operating losses would find their levels of capital even more difficult to maintain.

II. Stabilization of Agricultural Borrowers

The massive reversal of agricultural fundamentals--a return to a less inflationary environment, structural changes in financial markets, and U.S. integration into a world market for food and fiber--require extraordinary cooperation on the part of lenders, borrowers, and others. The banking industry is deeply concerned about the economic problems facing the American farmer. Bankers work closely with farm families in the management of their financial affairs and are quite aware of the financial difficulties many farmers are facing today. Many agriculture-related businesses, which provide products and services to farm families in rural America, are also suffering as a result of the financial problems of farmers. We believe the best approach for assisting these customers is for banks to work in partnership with regulators, customers and others to arrive at acceptable solutions. Forbearance and cooperation, until the farm economy improves, are the key to overcoming this economic crisis.

Banks already have engaged in loan renegotiation, interest-only payment plans, extension of loan maturities, and even significant rate reductions to assist struggling small business and farm borrowers through the current difficult period. We shall continue to do so. Federal assistance in the form of Farmers Home Administration guarantees or interest rate buydown programs enable more of us to help more borrowers. We believe this to be a very positive approach to helping those farmers who still have viable operations but who are caught up in the current financial crisis.

In addition to their announcement on capital forbearance, the bank regulators also announced two other policy changes that remove regulatory disincentives to loan restructuring. Until this announcement, banks were discouraged from restructuring loans by the regulations. These changes should aid banks as they try to work with their borrowers.

The first policy change involves acceptance of Financial Accounting Standard No. 15, a Generally Accepted Accounting Principle (GAAP). Previously, particularly under FDIC rules, if a bank restructured a loan, any reduction in expected bank income below that contained in the original note had to be considered a loss. Under the new policy, as long as a bank expects to receive an amount equal to the original principal and interest accrued(up to the date the loan is modified)over the life of the restructured loan, the bank does not have to recognize any loss. This policy change helps banks work with their borrowers by restructuring loans while also protecting the banks' capital levels.

The second policy change involves the reporting of restructured loans. Previously even if a bank restructured a loan and recognized a loss on the reduction from the original note, and even though the borrower made payments under the restructured terms, a bank had to report the loan to the regulators as nonperforming because it did not meet the provisions of the original note. Bank examiners classified these restructured loans as nonperforming. The regulators have created a new category for restructured loans that means such loans will no longer be classified nonperforming but rather be put in a new category, "Restructured and in Compliance with Modified Terms".

These two policy changes together remove a major regulatory disincentive to debt restructuring.

Mr. Chairman, we recognize the budget constraints within which the Congress is now working. Therefore, since the Farmers Home Administration loan guarantee programs are the least costly means of stabilizing, restructuring, and extending agricultural credit, we recommend a continued focus on the guarantee program.

Bankers are working with the FmHA guarantee program. According to the Department of Agriculture, on March 31 of this year there were almost three times as many FmHA Guaranteed Operating Loans (3,754) as there were at this time a year ago (1,236). There was a 240 percent increase in the total of guaranteed funds obligated ($438.6 million compared to $180.5 million in 1985) by March 31, 1986.

Use of the guarantee program does vary state-by-state and county-by-county due to variations in the degree of commercial bank involvement in agriculture, knowledge of and support for the program on the part of both lenders and FmHA administrators, and sheer volume of work in local FmHA offices.

We recognize the demands being made on FmHA staff, but prompt processing of applications is absolutely essential to the working of the guarantee program. When lenders do not receive prompt action on applications, they are hesitant to spend the time filling out new ones.

We are also supportive of the interest rate buydown program included in the 1985 Farm Bill. For some farmers, this type of direct assistance is the only thing that can allow them to survive. Unfortunately, the regulations only reached many FmHA county offices in mid-March. Our experience with programs of debt-adjustment clearly demonstrates that new programs, announced well into the planting season, are difficult for commercial banks to use because neither the FmHA administrators, the bankers, nor the farmers are familiar with the requirements. In addition, all new programs have adjustments that need to be made once the regulations are tried out in real world situations.

For example, while the interest rate buydown program has only been available for a few weeks, we have heard of many questions concerning the requirement that eligible farmers divest themselves of "any assets which do not contribute to essential family living expenses or to the maintenance of a sound farming operation." Who defines these assets? Who has the authority to disapprove an application on this basis? Both the lender and the County Supervisor are mentioned. This requirement is one example of items that need clarification.

Both H.R. 4267 and a proposed substitute for H.R. 3868 include debt restructuring and interest rate buydown provisions. We appreciate and share the concern of Members of this Committee about our farm borrowers demonstrated by these proposals. If funds are available to broaden the interest rate buydown program, we support this approach and look forward to continuing to work with the Members of this Committee to develop the most effective program that benefits our farm borrowers and guarantees continued availability of credit to agriculture.

III. Stabilization of Farm Real Estate Values

Mr. Chairman, as mentioned earlier, the value of farm sector assets has retreated since peaking in the early 1980s. The most pronounced decline has been in land values, which nationwide are off 19% since 1981. The extent of the decline varies widely among states, with the sharpest declines occurring in the western Corn Belt and the southern Plains states. Land value declines since the 1981 peak range from nearly 20% in Michigan to more than 45% in Iowa.

Our Association is interested in exploring possible solutions to the major problem of declining land values. An immediate action that would help reduce the downward pressure on farm land values would be changes in the requirements that banks divest themselves of agricultural real estate within a short period of time (five years for national banks, with an additional five years with Comptroller approval).

Dumping that land on a declining agricultural real estate market merely further deflates the asset values to which all of the lending in rural communities is tied. As a short-term measure, permitting banks to hold that agricultural land somewhat longer would definitely help stabilize farm real estate values.

The Joint Task Force recommended that the current limit of five years (with an additional five years if the Comptroller approves) be extended to ten years with an additional five years discretion for the Comptroller for national banks. States should be urged to make similar changes for state banks to prevent further dramatic declines in the value of farm land.

Due to the current agricultural situation, a farmer's long-term financing options are extremely limited. Agricultural banks are exploring the development of other sources of long-term credit, beyond traditional sources, which could provide competitive and stable funds for American farmers.

The acquisition of funds is an ongoing serious concern of the country's agricultural banks. During periods when interest rates are high, the small and medium size banks have difficulty in obtaining long-term loanable funds. On a long-term basis, it would be useful to create a true secondary mortgage market for real estate loans so that banks will have the opportunity to tap capital markets.

The ABA proposes the development of a secondary market for farm real estate. Providing banks with a secondary market for agricultural real estate would enable these banks to provide real estate financing at reasonable rates to the farm sector.

According to the Federal Reserve Board's 1985 estimates, the Farm Credit System holds 44.04% of the farm real estate debt, insurance companies hold 11.2%, Farmers Home Administration 8.87% with 26.79% held by individuals and others. Banks only hold 9.01% of the farm real estate debt. Banks cannot lend for long periods of time on farm real estate unless they have either long-term funds or a secondary market.

The development of a secondary market, perhaps with FmHA guarantees, would permit banks to make farm real estate loans, to sell these notes on the secondary market to maintain liquidity, while retaining the servicing and local involvement with their farm borrowers.

This secondary market would enable banks to continue financing farm real estate in periods of reduced bank liquidity because the loans could be sold to investors in this market. The development of this stable competition with the Farm Credit System would benefit both farm borrowers and their communities. Increasing competition, spreading the risk of financing farm real estate, and keeping banks as viable lenders all will help stabilize farm real estate values in rural communities.

Through the creation of such institutions as the Government National Mortgage Association (GNMA) and the Federal National Mortgage Association (FNMA), Congress has shown its support for encouraging participation in the secondary markets. These institutions are actively facilitating the needs of the mortgage industry by purchasing mortgages from the originator and reselling them to investors.

Because of these organizations the housing industry has enjoyed the benefit of a highly competitive and efficient credit delivery system. We would urge the government to play an active role in developing a secondary market for farm real estate.

Conclusion

It is particularly important that cooperative efforts are taken now to help with the current credit and cashflow problems facing farmers and commercial banks in many of our major agricultural regions. We certainly compliment this committee for turning its attention to the credit issue at this time. That is also why we are pleased by the announcements by the regulators that eliminate the regulatory disincentives for debt restructuring and that institute capital forbearance.

Our objective is to provide those banks and farmers who have the potential of survival with the opportunity to return to profitability. However, given the dramatic rate of adjustment in the agricultural economy occurring at this time, without some programs such as described above, many banks and borrowers with previously successful operations face insolvency.

Mr. Chairman, while we need time now we are also working as an Association to look to the future. The ABA has commissioned a comprehensive research report to assess: (1) the major trends in agricultural banking, (2) the future of the agricultural sector, (3) the agricultural credit delivery system, (4) regulatory and legislative actions consistent with these findings, and (5) a strategic planning guide to assist individual banks in their business plans and agricultural lending decisions.

Mr. Chairman, we will continue to explore the above mentioned issues with the Congress and the regulators.

STATEMENT OF JOHN C. DEAN, CHAIRMAN, AGRICULTURE-RURAL COMMITTEE, INDEPENDENT BANKERS ASSOCIATION OF AMERICA

Mr. Chairman and members of the Subcommittee, I am John Dean, Chairman of the Agriculture-Rural Committee of the Independent Bankers Association of America. I also serve as President of the Glenwood State Bank in Glenwood, Iowa.

We appreciate your interest in the serious problems involving agricultural debt and the financing of farm producers this year, and we are pleased to participate in these hearings.

At the end of 1985, commercial banks held about $47 billion of the outstanding farm debt, composed of $36 billion of production debt and $11 billion of real estate debt. This represents a 10 percent reduction of production debt and a 12 percent increase in real estate debt, compared with the end of 1984.

Net charge-offs of farm production debt by banks in 1985 totalled $1.3 billion, or 3.7 percent of the total of such debt. This is an almost 45 percent increase in the $900 million charged off in 1984.

Estimated delinquent farm production loans at commercial banks at the end of 1985 totalled $3.7 billion, of which $2.7 billion was categorized as nonperforming. The nonperforming loans include those past due 90 days or more and still accruing interest, non-accruing loans, and renegotiated loans.

Banks generally have ample funds for lending to agriculture, and most of the bank's farm customers now have their operating credit in place for 1986. However, there are many cases in which farmers are having difficulty qualifying for 1986 operating funds. The options available to lenders for working with such cases have become quite limited. The severe constraints on Federal expenditures in this area have also rendered this means for relieving the financial pressures less effective.

We have been working with the bank regulators and Congress to provide greater operational flexibility to banks in handling problem farm loans. We have emphasized the need for greater flexibility with respect to bank capital requirements as agricultural banks work with problem farm loans and loan charge-offs.

The two measures that are now being implemented by the bank regulators--capital forbearance and FASB-15--are quite similar to concepts included in H.R. 3868 and H.R. 4267 which are pending before this Committee. I would like to briefly review those measures that are being put into place by the bank regulators.

Capital forbearance as implemented by the FDIC, Comptroller of the Currency, and Federal Reserve will enable banks substantially involved in agricultural or oil and gas lending to participate in a program under which they may draw down their capital as low as 4 percent of assets (in special cases, 3 percent), where the pressure on bank capital is due to problem loans in agriculture and energy. The capital draw-down can be linked to a new Comptroller of the Currency policy on bank lending limits which is designed to preserve the size of an individual loan that the bank is permitted to make at or near the size permitted prior to the reduction in the bank's capital level.

FASB-15, which refers to a financial accounting standard that is consistent with generally accepted accounting principles, allows a bank to renegotiate a note case with a borrower and forgive repayment of a portion of the principal owed on the note while taking as a loss deductible against the bank's capital only the amount by which the forgiven debt exceeds the interest that will accrue on the remaining note until maturity. Under FASB-15, the bank examiners will not classify the remaining note as a problem loan, if the loan is performing under the modified terms.

I have attached a copy of each of three weekly reports to our membership that IBAA prepared on these measures, as they were developed by the bank regulators.

We believe that those regulatory measures provide useful, additional flexibility in dealing with problem loan cases. Each loan case is different, and whether one or another of these options is employed will depend on the circumstances of each specific case. This additional regulatory flexibility can benefit farm borrowers in several ways. These measures will give some renewed confidence to agricultural bankers to encourage extension of credit to farm borrowers. Maintaining the bank's prior lending limit while reducing capital levels can enable a bank to continue supplying the full credit needs of specific farm borrowers whose needs might otherwise exceed the bank's individual loan lending limit. The FASB-15 procedure involves the forgiveness of a portion of the farmer's debt.

These measures that are being developed by the regulators have the potential of accomplishing the basic objectives that a formal multi-year loan loss amortization procedure would be expected to perform, and we believe that proper implementation of those measures should now be emphasized.

The FmHA loan guarantee program provides another important means for handling stressed farm loans. That program is being used extensively in many heavily agricultural states. For instance, as of April 2, obligated guaranteed operating loans were $65 million in Iowa, $60 million in Nebraska, $50 million in Minnesota, $33 million in Oklahoma, $26 million in Texas, and $24 million in Kansas.

The interest rate buy-down program under the 1985 farm bill has been available only a few weeks, and apparently interest in this program is growing as the initial difficulties are worked through. Iowa recently added an additional interest reduction to this program, as it operates in the State. The interest rate buy-down is fully authorized in the 1985 Act, and because it is tied into the Agricultural Credit Insurance Fund it can be expanded merely by providing additional funding authority under the ACIF revolving fund. We support an expansion of funding as the demand for this program warrants, to the extent that funding can be provided without depriving other priority programs. We recognize that you face hard choices in the allocation of funds among deserving programs. We see no reason to rewrite the interest rate buy-down program at this time.

Direct FmHA lending obviously remains critical for farmers in many situations, and we support maintaining the funding for direct loans necessary to meet the needs of eligible farm borrowers.

One new avenue of farm lending that we are pursuing is the development of a broader secondary market for longer-term farm loans originated by commercial banks. If secondary marketing institutions can be developed for farm mortgages, commercial agricultural banks could originate a larger volume of farm real estate mortgages for resale. This could expand long-term credit sources for farmers. We would like to work with you in getting such a secondary market firmly established.

The ability of farmers to cash flow their debt load, both existing and new debt, remains the bottom line consideration in the financing of production agriculture this year. As indicated, certain programs and policies are now in place, that provide greater flexibility in enabling commercial lenders to accommodate qualifying farmers' credit needs. I am confident that agricultural banks and their borrowers will generally make the best possible use of those measures during this lending and production season.

This concludes my statement, and I would be pleased to respond to any questions.

(Attachments follow:)

SPECIAL SUPPLEMENT TO THE WASHINGTON WEEKLY REPORT March 21, 1986

New Options for Loan Loss Amortization

The bank regulators are now adopting two different regulatory policies that will be available to banks as options with which banks might preserve their capital levels while recognizing losses on agricultural loans. The two options, both of which involve variations of loan loss amortization, are: (1) capital forbearance and (2) FASB-15. The latter option (FASB-15) is available now; more details on capital forbearance will become available very shortly.

The way in which FASB-15 can be used is outlined below. Bankers may want to keep their options open in handling specific note cases until the capital forbearance option can also be considered. FASB-15 and capital forbearance will differ in terms of tax consequences and the requirement of debt forgiveness. The capital forbearance option may be more generally applicable, since it will not require the unusual step of debt forgiveness.

Although the emphasis with regard to capital forbearance and FASB-15 is upon troubled agricultural debt, these procedures will probably be generally available for handling other troubled debt (particularly energy loans).

FASB-15

FASB-15 refers to the *Statement of Financial Accounting Standards Number 15 for Accounting by Debtors and Creditors for Troubled Debt Restructurings*. The use of FASB-15 conforms to generally accepted accounting principles. Chairman Bill Seidman of the FDIC has instructed all FDIC examiners to accept FASB-15 procedures in classifying any bank loans, as long as the examiners are comfortable with the ultimate collectibility of such restructured loans. Comptroller Robert Clarke and the Federal Reserve have also emphasized that FASB-15 is available for use.

The use of FASB-15 allows a bank in effect to amortize a loan loss over the life of the new note, in cases where the lender renegotiates debt and forgives part of the principal so that the borrower can then cash flow the remaining debt as restructured in the new note. FASB-15 thus offers a potential alternative to foreclosure, but it requires that the lender take the unusual step of forgiving a portion of the principal that is owed.

As an illustration, assume a note case involving $400,000 of debt on which, for whatever circumstances, it is decided that the borrower can cash flow a maximum of $200,000 if that amount is amortized over 7 years with an increase in the interest rate from 12 to 13 percent. For purposes of determining the amount of loss to be deducted from the bank's capital, FASB-15 allows the lender, when the new $200,000 note is issued, to add to the principal the interest income that will accrue on that $200,000 over 7 years (in this example, $116,555 of interest). Thus, the first-year loss as a deduction against bank capital is $83,445 ($400,000 minus $316,555). In effect, the full $200,000 loss will be amortized over the 7 years, since income from the loan that will accrue over 7 years has been totally credited at the beginning of the new 7-year note.

For FASB-15 to serve its intended purpose, it would appear desirable to emphasize reduction in principal, and perhaps increase the interest rate, in order to minimize the amount of front-end loss that is offset against the bank's capital.

For tax purposes, it is generally believed that the entire $200,000 of write down of debt in the above example can be taken immediately by the bank as a tax deduction. The $200,000 is forgiven to the borrower, and therefore should be immediately deductible by the lender. The same $200,000 would constitute ordinary income to the borrower for tax purposes, subject to any special circumstances that apply.

Although the above debt restructuring example involved simply a modification of principal and interest, it is permissible to include a transfer of borrower assets and still use FASB-15. To do that, you subtract the value of the assets or equity interests that are transferred from the borrower to the lender, and then (unless that transfer is accepted as full settlement of the debt) you merely handle the modifications in the remaining debt according to FASB-15. For example, if the $400,000 in the above illustration was reduced to $300,000 by a transfer of assets, then the remaining $300,000 can be further modified (with reduction in principal and changes in the interest rate on a new note), complying with the FASB-15 procedures.

In a FASB-15 situation where the total interest income that will accrue on the new note after renegotiation exceeds the amount of principal forgiven, you would show no loss as an offset against bank capital at the beginning of the new note. In the above illustration, if the amount of principal forgiven remained $200,000 but interest income on the new note would total $205,000 (rather than $116,555), no loan loss would be recorded initially. The $200,000 would still be immediately deductible as a loss for tax purposes.

The FDIC, Comptroller of the Currency, and Federal Reserve are taking unified action, revising the bank call report to provide a separate reporting category for loans that are restructured and are in compliance with the modified terms of the new loan. Such restructured loans would no longer be categorized as nonperforming loans. The regulators made the joint decision approving this new call report category last Friday.

Capital Forbearance

As indicated, before electing to use FASB-15 for specific note cases, bankers will want to consider the forthcoming option of capital forbearance, on which more information will be available shortly. The capital forbearance option will allow a bank experiencing difficulties to operate below the minimum capital requirement (possibly as low as 3%) provided the bank has the capacity to restore capital within 5 years. Thus, capital forbearance may meet the need for preserving a bank's capital and lending capacity, while recognizing agricultural loan losses, without requiring the forgiveness of debt. And of course the full consideration of options must still include the possibility of foreclosure or other type of liquidation, which may be the only reasonable course of action.

Bank Capital and Lending Limits Preservation Policies

In addition to the FASB-15 procedures, the other regulatory flexibility option now being provided is capital forbearance linked with adjustments in lending limit regulations. The "linkage" between the procedures allowing reduced capital levels and preserving banks' higher lending limits is complicated by the fact that jurisdiction is split between FDIC (with primary control over reduced capital) and OCC (with control over lending limits).

Capital Forbearance

Chairman William Seidman is providing the details on FDIC's capital forbearance program in a letter of March 27 to all state-chartered banks that are not members of the Federal Reserve System. That program, which is effective immediately and extends through January 1, 1993, provides that the FDIC will not take administrative action to enforce normal capital standards against banks whose primary capital ratio declines to no less than 4 percent between now and December 31, 1987, provided the bank participates in the capital forbearance program under the following conditions:

- The bank must be an "agricultural" or "energy" (oil and gas) bank, whose agricultural and oil and gas loans (either separately or in combination) comprise at least 25 percent of the bank's total loans and leases.

- The weakened capital position of the bank must be largely the result of external problems in the agricultural and/or oil and gas sectors of the economy, and not due to "significant mismanagement" or related factors.

- The bank must submit to the FDIC a plan for restoring capital to the required minimums in incremental amounts by not later than January 1, 1993. This plan must address certain areas specified by FDIC, such as compensation to directors. The bank must agree to file an annual progress report with the FDIC regarding its capital plan and to keep the FDIC informed of material variances from the plan.

Banks seeking to participate in this program should provide written notification to the Regional Office of the FDIC, including evidence of the bank's eligibility and its plan. Participation in the program is granted unless, within 60 days of receipt of the application, the FDIC notifies the bank that its request has been denied or informs the bank that additional information is needed.

Capital forbearance could be extended to banks with primary capital ratios as low as 3 percent in special circumstances, if a bank's plan indicates that an increase to 4 percent will occur within a relatively short time (generally 12 months or less). However, approval of such a reduction in capital is discretionary with the FDIC, whose positive written approval would be required. In addition, the FDIC does not rule out extending the capital forbearance policy to a bank experiencing losses due to agricultural and energy problems but not meeting the 25 percent test for an agriculture/energy bank; those situations would be handled by the FDIC Regional Office on a case-by-case basis.

Lending Limits

Comptroller Robert Clarke is developing the regulatory procedures designed to preserve the limit on the size of individual loans at or near the level of a bank's lending limit prior to the reduction in capital resulting from a bank's participation in the capital forbearance program. This protection of lending limits would apply directly to nationally-chartered banks only. However, perhaps two-thirds of the states have "wild card" statutes under which the Comptroller's policies for preserving a bank's lending limits could be applied to state-chartered banks either automatically or by administrative action (that is, without requiring state legislative action).

In addition, the Comptroller's program of capital forbearance for nationally-chartered agricultural and energy banks (not yet issued as of March 27 but expected to be issued within a very few days) may provide for preserving the lending limits of higher-capitalized banks that reduce their capital under a capital forbearance program but still retain at least 5.5-6 percent capital. If so, that aspect of the program probably would not require the bank to submit a plan. As indicated, however, the Comptroller's capital forbearance program has not been finalized and issued.

To participate in a capital forbearance policy, a bank in each case will work with its primary regulator: nationally-chartered banks with the Office of the Comptroller, state-chartered non-member banks with the FDIC, and state-chartered banks that are members of the Federal Reserve with the Federal Reserve Banks. The Federal Reserve's capital forbearance program is also expected to be issued within a few days, and will be administered through the Federal Reserve Banks in the respective districts.

SPECIAL SUPPLEMENT TO THE WASHINGTON WEEKLY REPORT April 3, 1986

Bank Regulators Finalizing Capital Flexibility Options for Agricultural and Energy Banks

The bank regulatory agencies have almost completed the transmittal of information on the "capital flexibility" policies that they are implementing for agricultural and energy banks. All state-chartered banks which are not members of the Federal Reserve System should have received FDIC's March 27 letter on its capital forbearance program. All nationally-chartered banks should have received the Comptroller of the Currency's March 28 letter on the Comptroller's capital forbearance and lending limits policies. The Federal Reserve's related policies for state-chartered member banks was provided to the various Federal Reserve Banks rather than directly to those commercial banks.

Among the various measures being implemented (capital forbearance, lending limits protection, and FASB-15), only the Comptroller's lending limits policy requires a formal, published regulation. That regulation will be published in the Federal Register within a very few days, and is not expected to deviate materially from the explanation contained in the Comptroller's March 28 bank letter. The OCC lending limits policy will be immediately effective for nationally-chartered banks upon its publication, although a comment period will be provided with the possibility of changes based upon the public comments that are received.

Although the OCC's adjustment in legal lending limits may be essential in order to make the capital forbearance policy useful for banks, the lending limit adjustments will not be available to state-chartered banks except in states that opt into the lending limits policy based upon either a state "wild card" statute or (in the absence of "wild card" authority) special legislative action. Some agricultural states (Iowa and Nebraska, for example) do not have existing "wild card" authority, and in such a state it is important to consider legislation during the pending legislative session enabling the state to opt into the OCC program.

The following comments on the capital forbearance/lending limits policies may be useful for a bank's preliminary interpretation of those policies:

- Once a bank meets the eligibility requirements for capital forbearance including that the bank must hold agricultural and oil and gas loans comprising at least 25 percent of the bank's total loans and leases, then charge-offs on any type of loan (not only agricultural or oil and gas loans) can be included in the capital forbearance program whereby the bank would draw down its capital as low as 4 percent (3 percent in special circumstances).

- However, for the OCC's policy to offset the impact of the reduction in capital on the bank's individual loan lending limit, only the Special Category Loans (defined as agricultural and oil and gas loans) would be covered. The OCC is holding open the possibility of adding other types of loans to this Special Category, but has not done so initially.

- The OCC capital forbearance policy extends not only to banks whose capital ratios would decline below 5.5 percent, but also to higher-capitalized banks that reduce their capital under a capital forbearance policy and yet retain a ratio over 5.5 percent after the reduction in capital. Such banks need not apply for capital forbearance and submit a plan under the 60-day approval procedure. A potential advantage of participating for such a bank is that the lending limits offset would apply, and therefore the bank might preserve its legal lending limit at or near the level prevailing before the reduction in the bank's capital.

- The OCC's policy to offset the reduction in a bank's legal lending limit that would otherwise result from participation in the capital forbearance program, is designed to maintain a bank's general lending limit at 15 percent of the bank's unimpaired capital and surplus which existed prior to the reduction in bank capital--except that the "offset" lending limit could not exceed 20 percent of the bank's capital after the reduction. Therefore, a bank could reduce its capital by as much as 25 percent without lowering its general legal lending limit below 15 percent. For example, a $1 million capitalized bank with a $150,000 general lending limit could reduce its capital to $750,000 (25 percent) without impairing its general lending limit ($750,000 x 20% = $150,000). Any further reduction in capital would reduce the general lending limit somewhat below 15 percent based upon the prior capital level, because of the 20 percent ceiling on the offset.

This lending limit offset would also protect the special lending limits in existing law which allow the lending of an additional 10 percent (i.e., 25 percent of capital) to the same borrower if the loan is fully secured by readily marketable collateral, and the lending of even higher percentages of capital to the same borrower in specified exceptions (FmHA guaranteed loans, certain types of agricultural loans, etc.). However, those lending limits may not be completely preserved. For example, a $1 million capitalized bank with a $150,000 general lending limit that reduced its capital by 25 percent, but that had a $250,000 loan (the additional 10 percent) to a borrower where the loan was fully secured by readily marketable collateral, might have its lending limit reduced by $25,000 on this loan case ($750,000 x 20% = $150,000; $750,000 x 10% = $75,000; $150,000 + $75,000 = $225,000).

As indicated, the OCC's lending limit "offset" policy will be published within a few days, and is subject to change based upon the public comments that are received by the agency. But that regulation will be effective immediately upon publication, and therefore the regulators' package of capital flexibility options (capital forbearance, lending limits protection, and FASB-15) are basically in place and available for application to specific banks and note cases.

THE FARM CREDIT COUNCIL
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Statement by

Douglas D. Sims
Member of the Legislative Committee
The Farm Credit Council

On Agricultural Credit Conditions
before the

Subcommittee on Conservation, Credit and Rural Development
Committee on Agriculture

April 9, 1986

Mr. Chairman and Members of the Subcommittee:

My name is Doug Sims and I am the Chief Operating Officer of the Farm Credit Banks of St. Louis. I am testifying today as a member of the Legislative Committee of The Farm Credit Council, the nationwide trade association of borrower-owned farm lenders. The Council is made up of the 37 Farm Credit Banks and more than 90 percent of the Federal Land Bank and Production Credit Associations which make up the Farm Credit System and its nearly one million farmer/owners.

We appreciate the opportunity to appear before this Subcommittee to share our perspective on the serious financial issues confronting many U.S. farmers, cooperatives and their major provider of credit, the institutions of the Farm Credit System.

We first want to thank you Mr. Chairman, Mr. Coleman and the Members of this Subcommittee, for your diligence and your leadership in guiding the Farm Credit Amendments Act through the House this past fall. To you, we owe a special debt of gratitude for moving enormous obstacles and ultimately helping to obtain legislation which establishes the Farm Credit Administration as an arms-length regulator, provides an improved mechanism to administer System self-help and puts in place a backup mechanism for Federal financial assistance if the System's best efforts to manage its financial problems are unsuccessful.

The National Association Of Cooperative Farm Lenders -- Affiliated With The National Council of Farmer Cooperatives

Last Fall, the Farm Credit System provided detailed information to the Congress on the depth of its funding and financial problems. The somber projections we made at that time proved to be very accurate.

System Year-End Report

On February 14, 1986, the Farm Credit System announced its 1985 financial results, which included Systemwide operating losses of $2.7 billion. During 1985, the System charged off $1.1 billion in loans and made provision for future losses of $3.1 billion.

Our 1985 financial results mirrored another devastating economic year for many of our borrower/owners. Non-accrual loans totaled $5.3 billion, up $3.5 billion from a year earlier. On a Systemwide basis, acquired property increased from $504 million to $928 million during the year. Another $4 billion in loans which require more than normal servicing were identified and are now considered "high risk." These are the loans which, absent some material improvement in farm income, will be in serious jeopardy within the next two years.

Last year, Congress told the Farm Credit System to use its earned surplus to absorb losses. We in fact did that and in so doing, depleted 70 years of earned surplus by almost 45 percent from $6.2 billion to $3.4 billion.

These numbers and the complete financial report of the Farm Credit System for 1985 are contained in the System's Annual Report to Investors which has just been released. Copies will be provided to the members of the Subcommittee later this week.

As you review the Report to Investors, I urge your special attention to the unqualified audit opinion of Price Waterhouse, which is included in the report. Certainly, it is our fervent hope that these results will not be repeated in 1986.

The legislation which Congress enacted last year was very important to the farmers and ranchers who own as well as borrow from the Farm Credit System. The impact of the legislation was immediate and important in two respects. First, last fall the System came dangerously close to being shut out of the financial markets. Because of the legislation, the System's ability to sell its securities in the financial markets in the desired amounts and maturities was restored. Second, the cost of funds to the System skyrocketed late last year, threatening to add millions to the cost of credit for Farm Credit borrowers. Today the cost of money to the System has stabilized some 90 basis point below last year's peak spread against Treasury securities resulting in a savings to farmer-borrowers of more than $400 million on an annualized basis. The statute shored up a number of stockholder rights. We sense a renewed confidence in the System from investors, employees as well as borrowers.

Through the legislation, a funding crisis was averted. What has not changed, however, is the fact that the System remains essentially a single industry lender--a lender to an industry which has been severely buffeted by financial problems for upwards of five years.

Mr. Chairman, we continue to operate in a very difficult environment. The problem today is not the availability of credit. The problem is still the lack of borrower repayment ability. I am absolutely confident that the System is making every loan that has a reasonable chance of repayment. I believe we would be making those loans under more normal conditions, but I am doubly sure it is the case given the intense pressure on loan officers from every quarter within and outside the System to keep credit available. And yet, the System is faced with the need to operate on a sound business basis and to meet the equally important needs of the large majority of System borrowers who are making their payments.

The emerging problem that now threatens the System and all its borrowers is that Farm Credit System institutions' interest rates in many areas are becoming nonompetitive. As the volume of non-earning loans and acquired properties increases, our ability to be competitive decreases. All of these factors--including lingering concerns about System viability--have caused some financially-strong, long-time borrowers to move their credit business elsewhere.

Faced with the financial stress in the System, the financial stress in agriculture and with no prospects for immediate improvement in farm income, we have faced three choices over the past few months: to watch this cooperative lending system become nonviable one institution at a time; to come to the door of the Federal government with our hands outstretched for Federal dollars to help us become competitive once again; or to do some serious soul-searching, then take steps to re-establish the Farm Credit System on a sound business basis for the long term.

Mr. Chairman we have made the decision to move forward and make every effort to manage our problems internally. We believe that strategy is consistent with the central theme of the 1985 Amendments.

Implementation of The Farm Credit Amendments Act

The System is moving deliberately to implement the 1985 Act as swiftly as possible:

o Districts and associations have notified borrowers of the respective institution's forbearance policy, access to borrower's loan documents, and the institution's corporate articles and bylaws.

o New loan review committees are being established and implemented in each district.

o Districts have begun the process of notifying borrowers whose loans are classified as non-accrual and determining whether they can qualify for restructuring as a result of the '85 Act.

o Districts have developed a philosophy for working with the new Capital Corporation and the new FCA Board.

o FCA has chartered the new Capital Corporation and it has succeeded fully to the assets of its predecessor Capital Corporation.

o The System is proposing a draft financial plan for recommendation to the Capital Corporation board. We hope that this plan could form the basis by which the Capital Corporation would mobilize System resources to aid troubled System institutions.

o The System has accomplished the election of its members on the Capital Corporation board.

o The System has responded to FCA's emergency regulations on the organization and governance of the Capital Corporation. A copy of our comments is provided to the Subcommittee for the record.

We eagerly await FCA's appointment of two additional directors to the Capital Corporation board in order that an organizational meeting can be held and operations begun at the earliest possible moment. Though we are optimistic that appointments will occur in the very near future, the System-elected directors nevertheless feel obliged to set the new Corporation in motion and have indicated their intention to proceed with an organizational meeting of the board no later than May 1st, with or without the FCA-appointed directors.

A New Direction For Farm Credit

Beyond mere implementation of the 85 Amendments, System leadership has, over the past several weeks confronted a number of fundamental issues facing the System. The Presidents of the 37 Farm Credit Banks unanimously approved and System directors recommended to the Board of the Farm Credit Corporation of America, as the umbrella policy-making body of the Farm Credit System, several important resolutions. All have been adopted and copies are attached to my written statement. Let me highlight four key resolutions.

1. **The System will continue to press for quick implementation of the Farm Credit Amendments Act of 1985.**

2. **The System will develop a business plan to return the farmer-owned Farm Credit System to long-term profitability, and not to simply prepare for the day when we seek Federal financial help.**

3. **The System will implement a new pricing philosophy to achieve more competitive interest rates.** To better assure long-term profitability, and therefore, financial viability, the Farm Credit System must price its products and services to farmers, ranchers and cooperatives on a locally-competitive and differential basis, considering risk and costs incurred. Like any other financial institution, we must be able to retain our best farmer and cooperative borrowers and pursue marketing strategies which will attract new credit-worthy farmers, ranchers and cooperatives.

Differential rates are not new. Loans which require the least servicing and are the most secure often receive lower rates, while loans which have the greatest risk and weak repayment ability are usually more costly. Ultimately, this benefits everyone. Mr. Chairman, you can expect that we will be doing everything that we can bring interest rates to a more competitive level!

4. **The Farm Credit System is clearly on record that loan restructuring is the preferred alternative for working with troubled borrowers.** Foreclosure is the last alternative and the least preferred.

We recognize that a major element of our credibility with borrowers is directly linked to our ability to help those farmers who are having the most difficulty making payments. Contrary to what you often read, the decision to foreclose on a farmer is not a decision easily or quickly made by any of our farmer-board members of any Farm Credit System institution.

It is on this basis that the Farm Credit System--its banks and associations--are making the commitment to administer troubled loans to farmers with the objective of utilizing all measures, including FmHA guarantees and participation in Federal or state-funded interest-rate buy-down programs as preferred alternatives to foreclosure.

Like any decision made by the associations and banks of the Farm Credit System, restructurings must be undertaken on a case-by-case basis. Let's first understand Mr. Chairman, that to the extent that restructuring implies forgiveness of principal or interest, we're talking about giving away the capital of other farmer-owners. They won't object to this as long as it is done on a sound business basis. We will pursue restructuring alternatives when:

o The borrower has acted in good faith to manage his business affairs,

o The borrower can present a plan which demonstrates realistic prospects of getting through current financial stress for a return to financial viability,

o The restructuring will minimize any losses which must be borne by other farmer/borrower/stockholders of the bank or association.

What I have just outlined is a tall order for any institution which has incurred record losses, but it is not impossible. It will take cooperation in several key areas and a belief that farmers and their Farm Credit System will survive the current economic straits.

From a recent poll of the Farm Credit districts we know that System entities intend to participate in the FmHA interest rate buy-down program, authorized in the 1985 Farm bill. We know that they are more aggressively seeking to utilize the FmHA loan guarantee program. They are conducting joint training sessions with FmHA, and many have assigned one or more staff to work full-time with FmHA on ways to improve the delivery of their programs to System institutions. Two thirds of the nation's production credit associations have qualified as FmHA Approved Lenders.

Mr. Chairman, several legislative proposals before the Committee seek to encourage agricultural lenders to go even further to forebear, to restructure loans and to forgive debt owed by their farmer/borrowers. It is a simple fact, we have limited resources which we are stretching as far as we can. With taxpayer support, with the commitment of Federal dollars to assisting in lowering interest rates to farmers, clearly more restructuring could be accomplished. How much additional restructuring depends on how much the Congress is willing to commit. Every loan decision is made on a case-by-case basis, taking into consideration all options and alternatives available. If you provide us a new tool, I assure you that we will do our best to use it to the extent our regulator will permit it.

Finally, Mr. Chairman, let me comment on another major concern to the System. At present, the System and the FCA are in the process of establishing a new arms' length relationship as was intended in the 1985 Act. Yet FCA retains most of the long-standing authorities which have permitted the agency to direct the management affairs of the System over the years. We are committed to working with agency officials to bring about FCA's withdrawal from System operations. Specifically, System institutions must have the flexibility to set their own interest rates. At present, no interest rate changes can be made by a district without FCA approval.

As a result of a February 14, 1986 memorandum from FCA, entitled "Capital Directive No. 1," FCA considers the current capital of banks and associations of the System to be "at the level of minimum adequacy under existing circumstances..." and that "any action ....that has the effect of dissipating the institution's existing capital resources, decreasing its revenues, or otherwise diminishing its capacity to provide financial assistance to other institutions" is prohibited.

The effect of this directive is that every institution in the System now has questions about the extent to which FmHA programs and other restructurings can be undertaken, or whether any state interest buy-down programs can be used.

Mr. Chairman, we will continue to press for FCA's withdrawal from this and other management aspects of System operations to achieve Congress' intention to establish more credible regulation of System institutions.

In summary, Mr. Chairman, I find among the officers and directors of the Farm Credit System, at present, a very strong commitment to fully and swiftly implement the Farm Credit Amendments Act of 1985 and use the tools which the Congress provided through that legislation. We heard the Congress tell us to operate the System on a business-like basis but with the expectation that we will deal with compassion toward those who have no reasonable prospect for financial viability. With the required FCA approvals of needed interest rate reductions, we plan to move aggressively to implement a new pricing philosophy that will enable the System to once again be interest rate competitive. I find a dedication to pursuing every reasonable alternative to remain with troubled borrowers and to vigorously pursue opportunities for greater participation in FmHA guarantee programs and in loan restructuring as the preferred alternatives to foreclosure.

Mr. Chairman, farmers and their lenders are faced with the most difficult situation they have faced since the Depression. The challenge before the System is to work through the most troubled loans, loan by loan, in an attempt to help as many of our farmer/borrowers through this difficult transition as we possibly can while striving to maintain the System as a sound, dependable, and competitively viable provider of credit and related services to U.S. agriculture for the future.

Again, for The Farm Credit Council, I appreciate the opportunity to appear before this Subcommittee. I will be pleased to respond the Subcommittee's questions.

(Attachment follows:)

RESOLUTION #1

Through FCCA, the Farm Credit System will:

A. Develop a business plan to return the system to profitability.

B. Continue to press for prompt implementation of provisions of the Farm Credit Amendments Act of 1985.

C. Further develop and improve the system's financial reporting and forecasting capabilities, including uniform assumptions on systemwide variables.

D. Monitor and communicate system financial conditions and projections to appropriate publics.

E. Develop contingency plans for the system under a variety of assumptions, including federal assistance.

RESOLUTION #2

The Farm Credit System will develop a constructive relationship with FCA which will:

A. Allow FCA to carry out its responsibilities as an arm's-length regulator.

B. Minimize the cost of regulation to the Farm Credit System, its owners and borrowers.

C. Maximize the ability of the system to manage its affairs and return to long-term profitability.

In keeping with the above objectives, FCCA will coordinate systemwide responses to FCA regulations and practices. FCCA and the Farm Credit Council shall work on the system's behalf with FCA and the Congress where necessary to reduce the growing regulatory reporting and operational approval burden on system banks and associations, while actively promoting the use of uniform accounting, reporting, financial and credit practices throughout the system.

RESOLUTION #3

To retain market share and restore long-term profitability, the Farm Credit System will price its products and services on a locally competitive and differential basis considering risk and costs incurred.

FCCA shall develop model pricing programs to accomplish the above objective.

FCCA shall work, on behalf of the system, to obtain FCA approval of model pricing programs and to achieve implementation of such programs in each district.

FCCA shall catalog those products and services and those programs for competition surveillance which have proven successful in various districts and make such information available to all districts.

RESOLUTION #4

The Farm Credit System should endorse and adopt the credit standards adopted by the FCCA board to ensure sound and constructive credit extension and administration throughout the FCS. It is recognized that not all institutions can immediately comply with all standards, but it shall be the system's intent to achieve these standards over time, consistent with agricultural and operating conditions.

The system recognizes that successful performance in credit extension and management is beneficial both to borrowers and to their institutions to ensure reasonable cost of credit to borrowers over time.

FCCA shall monitor and report the performance of each district's compliance with system credit standards and assist districts reach the credit standards as appropriate.

RESOLUTION #5

It is the desire and intent of the Farm Credit System to maintain the long-run financial integrity of the system through effective credit and business practices. To this end, the system will establish and aggressively pursue marketing strategies with competitive policies and practices to attract and retain credit-worthy customers, recognizing that borrowers can best be served if the system maintains and enhances its strength by extending credit on a sound and constructive basis.

Recognizing the success of our efforts is dependent on the implementation of our programs, we express appreciation to all current Farm Credit employees for their dedication and efforts during this difficult period. FCCA shall develop and propose programs to assist districts improve marketing, member-borrower relations and employee morale.

RESOLUTION #6

To better manage interest-rate risk and protect system profitability, the Funding Corporation and FCCA shall develop programs which will provide the system continuous access to funding, at a wide range of maturities. The Funding Corporation shall also analyze and develop strategies to assist the banks in reducing the cost of funds.

RESOLUTION #7

The banks and associations of the Farm Credit System will administer troubled accounts with the objective of utilizing FmHA loan guarantees and other loan restructuring measures, including participation in federal- and state-funded interest rate buy-down programs, as preferred alternatives to foreclosure.

Restructuring should be accomplished on a case-by-case basis when:

* The borrower has acted in good faith to manage his business affairs and has been cooperative with the bank or association;

* The borrower can present a plan with reasonable assumptions showing a high probability of return to financial viability as a result of the restructuring; and

* The alternative chosen will minimize any loss that will be borne by the other borrowers/stockholders of the bank or association.

FCCA shall develop:

* systemwide guidelines and definitions for the restructuring of troubled loans;

* systemwide guidelines and definitions for the management and disposition of acquired property; and

* reasonable means of monitoring and reporting district efforts in the restructuring of loans and the management of acquired property;

FCCA and the Farm Credit Council shall communicate system efforts in this regard to appropriate publics.

RESOLUTION #8

FARM CREDIT SYSTEM MISSION

The Farm Credit System will be the nation's premier provider of credit and financial services to farmers, ranchers, cooperatives and other eligible entities.

FARM CREDIT SYSTEM STRATEGIC OBJECTIVES

The Farm Credit System will:

1. Be a dependable source of high-quality, financial and credit-related services to all qualified customers.

2. Price products on the basis of competition, risk incurred and cost of delivery.

3. Maximize efficiency and effectiveness in the delivery of products and services and in the management of human and physical resources.

4. Maximize long-term profitability to support growth, strengthen the system's capital base, and provide a competitive return on owners' investment.

5. Assess, manage and control credit, interest-rate and liquidity risk.

FCCA shall develop a systemwide strategic plan and an operational business plan in accordance with the above Mission Statement and Strategic Objectives.

STATEMENT OF THE
AMERICAN COUNCIL OF LIFE INSURANCE

Statement Made By:

Leslie G. Horsager
Vice President
Prudential Insurance
Company

Mr. Chairman and Members of the Subcommittee, I am Les Horsager, Vice President, the Prudential Insurance Company. The following testimony is submitted on behalf of the American Council of Life Insurance ("ACLI"). The ACLI is a trade association with a membership of 629 life insurance companies. In the aggregate these companies account for approximately 95 percent of the life insurance in force in the United States and hold 96 percent of the assets of insured pension plans.

Background

The life insurance industry is a provider of agricultural real estate financing of long standing. Many of the life insurance companies providing capital to agriculture today have been doing so for more than 100 years. Farm mortgages make a positive contribution to a well balanced investment portfolio. Insurance companies are familiar with the risks and rewards of farm lending.

The life insurance industry presently has just over $12 billion outstanding in mortgages secured by agricultural real estate, and, in addition, a significant amount is invested in agriculturally related businesses through bond and common stock holdings. It is our desire to continue that investment experience and to utilize our staff and infrastructure that has been carefully developed over the past century to provide private capital to agriculture on competitive terms. The life insurance companies have a successful record of perseverance and dependable service to agricultural finance through good times and bad. We continue to support our respective portfolios of farm assets in an atmosphere of unrestricted, healthy, and efficient competition. We have taken risks and enjoyed the rewards. We have also suffered losses. Investment in American agriculture by private enterprises has always been a healthy and much needed activity for the agricultural borrower.

The Current Situation

Our industry is active in nearly every major farm state. New mortgages continue to be made today even in the face of the current agricultural situation. This further serves to demonstrate the commitment of the industry to provide capital to agriculture, as well as indicate that qualified and credit-worthy borrowers are able to obtain financing.

Life insurance companies' agricultural loan portfolios are not without problems. At the end of 1984, there was approximately $1.2 billion or 10% of the loans by volume delinquent or in foreclosure. This compares with $240 million or 2% in 1980. In 1984, insurance companies acquired by foreclosure or involuntary conveyance just over $250 million in agricultural property. Preliminary indications suggest that these numbers will be higher in 1985.

The continued decline in the prices of agricultural commodities and assets and the uncertainty in credit markets contribute to the decline and instability of the agricultural sector. It also discourages new investment, increases the cost, and reduces the volume of credit that is available. This deterioration of the markets, together with the financial stress on the agricultural sector, is expected to continue in the near term and will negatively impact:

- Federal, State and Local tax revenues
- Infrastructure of the food production system
- Services available in rural communities
- Businesses that merchandise, process or market agricultural products
- Agricultural credit sources

Widespread media coverage and public attention is being focused on the "Farm Credit Crisis." The Congress recently enacted the "Farm Credit Amendments Act of 1985" (P.L. 99-205) to reorganize and rescue the Federal Farm Credit System. While we believe strongly in preserving the financial integrity of the Farm Credit System, we are also concerned about the ability of other agricultural lenders to continue to participate in the industry.

The availability of several alternative sources of credit assures efficient and competitive markets for agricultural credit.

A disadvantageous position imposed upon private lenders will discourage new sources of capital from entering the agricultural credit market, and encourage an exodus of those now active in providing credit. Any program designed to stabilize the agricultural credit industry over the long term must seek to insure continued private lender participation.

We hope and expect that if taxpayer assistance given the Farm Credit System ameliorates the pressures on Farm Credit System borrowers, equal benefit will be available to non-Farm Credit System borrowers. The proposal for an interest rate buydown program as provided by H.R. 3868 deals realistically with the problems using participation from both private and public sector institutions. We strongly support these types of programs and believe they are a significant step towards dealing with today's problems.

The Long Term

In the long run, American agriculture should be a full participant in various American capital markets. We believe that this is clearly in the best interests of agriculture, of the taxpayers and of the nation in general. The alternative is that American agriculture increasingly becomes a ward of the Federal government as to its credit needs.

We believe that competition and market discipline can be restored in the agricultural credit industry. To do so requires a healthy private sector lending capability. In our view, private lenders could compete, despite the pricing edge of government agencies, if there was adequate liquidity for their investment portfolios. While insurance companies may currently have a need for long-term farm mortgage investments, portfolio managers are reluctant to acquire significant amounts of these investments without assurances that they can be remarketed as their investment portfolios need rebalancing.

Liquidity has been provided in other long-term mortgage investments, such as the residential mortgages, by the development of a secondary market in these investments. It should be noted, however, that these secondary markets developed only after government-sponsored agencies provided mortgage insurance as well as standardization within the industry. With an extensive secondary market for such mortgages, life insurance companies are once again major mortgage investors to the benefit of many home buyers.

Insurance companies believe the same concept should be developed in the agricultural mortgage business. If sufficient liquidity could be established through a secondary market for agricultural mortgages, our companies would be able to increase their participation as a major provider of long-term capital to agriculture, thereby increasing farmers' access to the nation's major capital markets. Just as homeowners in small communities throughout the nation have been served by the development of a secondary market for residential mortgages, farmers throughout the country would benefit from the development of a secondary agricultural mortgage market.

We believe American agriculture would benefit greatly from increased availability of private sector financing. The major advantages of private sector participation are several:

1. The private sector is enormous and highly diversified. Diversified sources of credit assure safety for farmers and investors alike.

2. The private sector is innovative and fiercely competitive. Such features have historically acted to the benefit of its customers.

3. The private sector could promote the development of a secondary market for agricultural mortgages thereby providing a method to recycle capital from the major capital markets back into rural areas.

A basic feature of private sector financing is that its interest rates and terms are, at all times, reflective of the current capital markets. Some will say commercial agriculture cannot afford financing at commercial rates and terms. This is, in our experience, not the case. Realistic interest rates encourage realistic borrowing and provide an on-going discipline for all enterprises that use borrowed capital.

Given the tendencies of land prices to appreciate excessively when below-market financing is available, it can be asserted that in the long run agricultural assets will be more soundly priced and valued if interest rates are at commercial market levels. Viewing the last ten years, this would certainly have been a blessing to all concerned.

We believe American agriculture would benefit greatly with increased availability of private sector financing. Indeed, what agriculture needs is direct access to today's capital markets where interest rates have dropped significantly in recent months. Clearly, the American taxpayer would benefit in two ways. First, most private sector sources are subject to Federal income taxation on their investment income. Second, the possibilities of a repetition of this current demand for massive bailout would be materially reduced since sources of agricultural credit would be spread more diversely amongst investors.

For these reasons, we recommend that an equitable treatment of all agricultural lenders be established as a matter of on-going public policy. We also recommend that Congress seriously consider proposals to enhance liquidity for agricultural mortgages through the development of a secondary market. Our companies are currently developing a plan in conjunction with other farm lenders through which long-term agricultural lenders can enjoy more liquidity in their loan portfolios and thereby increase the share of private capital invested in American agriculture. We believe this will result in greatly increased private sector participation to the betterment of both lenders and borrowers.

STATEMENT OF THE AMERICAN FARM BUREAU FEDERATION BEFORE THE SUBCOMMITTEE ON CONSERVATION, CREDIT AND RURAL DEVELOPMENT HOUSE AGRICULTURE COMMITTEE WITH REGARD TO AGRICULTURAL CREDIT

Presented by

Dean Kleckner, President, American Farm Bureau Federation

April 9, 1986

Mr. Chairman, Farm Bureau appreciates the opportunity to testify today on agricultural credit.

I am Dean Kleckner, President of the American Farm Bureau Federation and a farmer from Rudd, Iowa. I operate a 550 acre farm where we produce corn and soybeans as well as raising and marketing about 1,800 hogs annually.

For the past five years, agricultural finance policy has been driven by the "one more year" syndrome. The goal has been to keep borrowers and lenders solvent for one more year hoping that the debt/income situation would correct itself. Since farm operators and lenders are partners and one cannot survive without the other, actions were taken on the assumption that anything that would help one would help the other.

This "one more year" policy was based on the idea that the debt problems of agriculture were caused primarily by forces beyond the control of the farm operator. Once these outside forces, such as high interest rates, a strong dollar, low exports, declining land prices and high production costs went back to "normal," everything would be fine. These outside forces were contributing factors, but not at the root of the debt problems and changes in these forces will not eliminate the debt pressures.

Agriculture has run out of "one more years." As a policy, that approach is now obsolete. Those short-term lenders who have loaned money on equipment and livestock to pay interest and principal on land have said, "No more." Most operators are reluctant to further mortgage land to cover unpaid operating expenses.

Operators with the greatest debt problems have substantial amounts of nonworking debt that require the servicing of principal and interest but provide little, if any, cash flow to the business.

For 1986, the agricultural finance policy debate has been focused on the immediate problems of the one-third of commercial agricultural operators that hold two-thirds of the debt held by all farm operators. About half of this group, 100,000 to 125,000 farm operators, are at the point where substantial debt restructuring will be needed over the next two years to avoid liquidation, either voluntary or forced.

A substantial reduction in debt load or a reduction in the debt that has to be serviced out of current income is absolutely essential. Only this will bring long-lasting financial relief to stressed farm operators. For some portion of the farm operators, no reasonable amount of debt relief will be sufficient to deal with their debts.

Several months ago, Farm Bureau set out to develop a debt restructuring plan to aid financially stressed farmers who, under the right circumstances, have the chance to survive.

The American Farm Bureau Federation has proposed a Two-Tier Debt Restructuring Program to deal with long-term financial problems.

The program would start with the farm operator and the lender analyzing the individual operation to determine how much debt could be paid under normal circumstances. That would become Tier 1 debt. On this Tier 1 portion of the debt, the farm operator would pay the regular interest and principal payments over 10 to 20 years. The remainder of the debt would be put into Tier 2, where it would carry an interest rate of 3 percent with no principal payments. As a portion of the Tier 1 debt is paid off annually, debt would shift from Tier 2 to Tier 1 until all the two-tier debt is paid.

For example: A farmer has a $300,000 debt, and after an analysis, the lender and the farmer decide that $200,000 can be properly serviced; that becomes Tier 1 and the remaining $100,000 becomes Tier 2 debt. The key is debt restructuring--not debt forgiveness.

Some steps are necessary to make the program work. Tier 2 debt must be monitored separately by regulatory authorities so that it is not discriminated against or classified against the capital of the financial institution.

Let me say at this time that we are pleased that the banking regulators have made two-tier debt restructuring, as well as other forms of debt restructuring, possible through issuing new regulations. As of March 28, the Federal Deposit Insurance Corporation, the Federal Reserve System and the Comptroller of the Currency had sent notices to their banks to employ a common set of general supervisory policies to assist troubled banks. Those policies included capital forbearance, changes in the call report requirement, and a reaffirmation of the use of Financial Accounting Standards Board Rule #15. FASB 15 simply says that a loan may continue to be carried on a bank's books without any loss recognition if the loan is restructured in a manner so that it is probable and estimable that the borrower can repay the loan under the new terms, and that the total future cash payments by the borrower (principal and interest combined) at least equals the loan amount on the bank's books. Therefore, our two-tiered debt restructuring proposal would be available for a bank's use since no debt is forgiven.

Let me emphasize that we believe that the new regulations issued by the three bank regulators, along with the reaffirmation of use of FASB 15, could aid a high percentage of debt-ridden farmers. I think most would agree that the regulators would not have taken these steps had not Congress, Farm Bureau, and a few other groups put pressure on them to do so.

As well as meeting and working with the bank regulators to achieve debt restructuring and capital forbearance in the past few months, we have been taking similar actions with the Farm Credit Administration. Unfortunately they have given us no indication that they intend to make any changes towards forbearing with their borrowers. In fact, we hear on a daily basis about FCS borrowers who have been foreclosed by the System, only to have the System sell the land to someone else several hundred dollars per acre cheaper, with one to two percent lower interest rates, and with no purchase of stock required. In some of the cases, had the original borrower been given anywhere near that kind of a deal, he too could have made a "go" of the operation.

Because of this attitude, we are asking Congress to help persuade the Farm Credit Administration and the Farm Credit System to practice forbearance rather than foreclosure. Just before the Senate adjourned for the Easter recess, Senator Nickles (R, OK) introduced Senate Concurrent Resolution 122 expressing the sense of Congress that the FCA should take actions to alleviate the unusual financial situation facing borrowers if there is a reasonable prospect that the borrower will eventually be able to repay the loan.

The FCA is urged to:

1) Make use of agricultural loan restructuring programs;

2) Classify restructured loans as "performing" as long as the restructured payments are being made;

3) Permit multi-year amortization of loan loss write-offs;

4) Compare the cost of foreclosure on a loan with the cost of restructuring, and if restructuring is less expensive, use it; and

5) Consider two-tier debt restructuring as one way to restructure debt.

Farm Bureau believes that unless Congress acts positively on this resolution or something similar to it indicating their concern to the FCS, no progress will be made in changing their attitude from foreclosure to forbearance.

We appreciate the opportunity to testify.

NATIONAL
FARMERS
ORGANIZATION

Subcommittee on Conservation, Credit
and Rural Development
Committee on Agriculture
U.S. House of Representatives

STATEMENT
CHARLES L. FRAZIER
National Farmers Organization
April 9, 1986

FARM CREDIT LEGISLATION

Mr. Chairman, we appreciate the opportunity to appear briefly before your Subcommittee this morning. It is my understanding that the purpose of this hearing is to review the credit situation currently prevailing in most of our farm communities and how well our government agencies are moving to cope with the problems.

It should not be necessary to reiterate the nature of the problems because they have been discussed in everything from church bulletins and suicide reports in the local press to the front page of the Wall Street Journal. It is necessary, however, to remind the Committee that, as yet, we have no real improvement in the economic status of most mid-range farmers. We do not believe that the decline in land values has bottomed out.

The Congress placed a lot of confidence in the proposition that cheaper farm commodities would expand our share of the export markets in the future when price support loan rates were lowered in the 1985 Food Security Act. Even the most favorable appraisal of the possible benefits in that approach must conclude that better prices may be expected in the distant future. In the meantime, a number of owner-operators who are largely dependent on farm income for their livelihood cannot arrange adequate financing to go in the fields this Spring. Political statements predicting a brighter future, and the expressed good intentions of all concerned, are meaningless so long as the managers of local credit institutions are reluctant to reorganize credit arrangements with producers and advance the necessary funds.

Governor Wilkinson of the Farm Credit Administration released a statement on the contents of his letter to the Executive Officers of the Farm Credit Banks at the time of his retirement as Governor March 28, 1986. He expressed concern that the increase in mergers and consolidations of System institutions may have disrupted communication lines with the FmHA administrators at the local level and wisely emphasized the importance of cooperation in meeting producers' credit needs.

We must keep in mind that this farmer-owned Farm Credit System made up of 37 banks and about 500 credit associations reported a deficit of $2.7 billion last year. It seems to have been agreed within the Administration, following your action in the 1985 bill authorizing the reorganization of the System, that the first obligation of management is to assure the survival of that System. Some of us representing producers believe it is at least equally important that the mid-range owner-operators also survive through the next few years.

We have undertaken to check on the effectiveness of the working relationship between local lenders with inquiries in two typical farm communities in the Midwest and the Southeast. It is assumed that it is too late to move new legislation that would help farm borrowers this Spring. Our spot checks indicate that all is not well -- that the Governor was on the right track in his effort to encourage cooperative action.

The Midwest

In this Midwest community, the typical farming operation is based on livestock and grain. They have experienced some drought in the last three years. The Production Credit Association that was very strong only a few years ago is now almost completely out of business. They are referring loan applicants to another PCA located 150 miles away. One bank went under and about 25% of the producers farming in this community five years ago are now out of operation. One third of the business houses are no longer open for business. One factory in the largest business center in the area has closed. It is highly questionable whether 20 to 30 percent of those still in farming will survive after 1987. Unfortunately, these are the mid-range owner-operators who rent some land. They do not have substantial off-farm income.

Reliable people in that area advise that ten to twenty percent of the fields normally planted by tenants will not be planted this year simply because some operators cannot find operating money. As to availability of FmHA loan funds, we are told that there is no money available for direct loans. When one questions the use of the Guaranteed Loan Program by local banks, it is reported that the paper work necessary to support such a loan takes two to four days of effort on the part of a responsible person in the bank.

One banker states, "This might be worthwhile if we were making a ten year loan, but it is too much red tape to assemble a man's record over five years of operation and work up all of the papers required for a short term operating loan." Local lending authorities understand that the 1985 farm legislation reduces loan rates and will reduce price levels. The promise of government payments notwithstanding, they expect farm income to decline again this year. Under these circumstances they are much more conservative than last year in approval of loans.

THE SOUTHEAST

Farming in the community examined depends upon tobacco, peanuts, grain and some livestock for income. There are no FmHA direct loan funds available. The managers in the Farm Credit System are undertaking to push borrowers toward the FmHA but that organization is swamped with its work load. Local banks object to the paper work, legal checking and time involved to arrange a guaranteed loan.

A local authority estimates that 65 percent of the producers do not have adequate funds to get corn and soybeans planted. One farm supplies merchant had to carry over from last year 25 unpaid accounts amounting to $1.8 million. This year he will deliver only on a bank letter of credit or similar written assurance from the FmHA or the FCS.

The status of farming in this community is well demonstrated by the plight of one typical family farm operator. The man is well educated and a good manager. His wife teaches school. They are in financial trouble as a result of three years of bad weather following expansion of this operation in the 1970s. Although they sold 250 acres in a consolidation move over the last two years, this family owns about one half of a 640 acre operation. They farm pieces of land owned by three other landlords.

Their needs for the 1986 season amount to $125,000 for operating capital. To date, the Federal Land Bank and the PCA argue that they cannot go along with a restructured 30-year loan sought by the operator or extend the annual credit needed. Last year this family met almost all its obligations, but fell a little short because nineteen inches of rain in July ruined the tobacco crop.

When they approached the FmHA, that office was friendly but contended their's is not a family farm. All the labor is furnished by the family, two hired hands and some supplemental labor picked up at harvest time.

This operator raises two precise and appropriate questions. If the FCS closes him out they will stand a loss, put his land on the market at lower prices and give some buyer a break on interest rates. Why not reorganize the debt on a 30-year basis, with annual payments the operator can carry and interest rates that reflect today's market? There are a number of good farmers in the same boat in this community.

If the FCS is too busy saving its own skin, why can't the FmHA get straightened out on the definition of a family farm? Agency personnel acknowledge this would be a good loan. It is reported that the FmHA is using several different definitions of a family farm at the local levels.

An Observation

Thomas Jefferson is quoted as saying that, "Banking establishments are more dangerous than standing armies." Since he was a farmer, I accept his opinion, but it must also be noted that we can hardly do without the banks.

After five years of concern with a broken economy in rural areas it should be possible to agree on a set of corrective steps that would spread the burden of adjustment necessary to refinance farming. If agency personnel will move to use the provisions of the Food Security Act of 1985 to finance operations this Spring and complete the reorganization of the FCS, then the next actions of a long range nature might embrace these methods or policies:

-- Acceptance of the view that it is in the national interest to assure the continuation of the mid-range, individually-owned and operated farming units in rural America;

-- Acknowledgement that the costs of farm programs have reached astronomical levels in recent years and simultaneously failed to protect the class of farm producers we wish to save;

-- Admission that lenders will either own some land for a very long time or they must accept a write-down on values; this being so, it is preferable to extend new loan terms to those current borrowers who know the land than to dispossess such owners in favor of new absentee purchasers; and

-- Necessity of accepting lower interest rates and long- range terms for repayment of the restructured loans that would be offered by the FCS, the FmHA and private lenders.

If such a broad based approach can be undertaken with confidence, there is every reason to believe that the government might very well arrange to recover its share of the cost of the program in the later years of the repayment schedule.

Recommendation

Two bills, H.R. 4267, introduced by Mr. Bedell and several other members in February, and H.R. 3868, recently introduced by Mr. Panetta, Mr. Jones, Mr. de la Garza and others, both contain sound provisions dealing with the farm credit problem on a long term basis. The Committee is urged to develop a bill that will assure the survival of the mid-range farm owner-operator that is so important in our rural communities and to our American way of life.

In the meantime, it is also quite important that more meaningful cooperation between lenders be developed quickly at the local levels to assure prompt service for deserving loan applicants this Spring if they are to continue in farming.

If we may be of help to you, please call on us.

TESTIMONY FOR

DAVID SENTER

NATIONAL DIRECTOR

AMERICAN AGRICULTURE MOVEMENT, INC.

Mr. Chairman,

Thank you for allowing me the opportunity to testify before this committee in regard to the current farm credit situation. It's springtime, the time when farmers should be in the fields planting this years crops. Instead, many farmers are still trying to find financing. The situation is critical.

Farmers are still fighting a declining farm income The value of farmland throughout the mid-west has fallen by 42 percent since 1981. The land devaluation alone has caused many producers to suddenly find themselves facing financial insolvency since their land will no longer cover their debts. These problems of declining income, reduced assets, and increased debt-to-asset ratios have grown in proportion the last year so that not only farmers are hurt but agriculture lenders also are in trouble.

As you try to put some type of farm credit legislation together that will help both farmers and agricultural lenders, I ask that you please consider the following recommendations.

1. Moratorium - any emergency assistance plan should contain some type of foreclosure protection to keep the producers on the land until a solution to his problems can be found.

2. Operating money - time is of essence. Farmers need money to plan this years crop, NOW. We favor a 50% advanced CCC loan on this years crop since this method could be in place quickly by utilizing existing programs and personnel with a minimum of modifications.

3. Deferred Payback - debt restructuring should allow for an extended payback period linked directly to the farmers ability to pay.

4. Lender Write-Down - we believe lenders should write-down a portion of the debt and interest. In return, the lenders should be able to write off their losses over a 10 year period. Some assistance may be needed from the state and federal governments in order to write down enough debt to allow the farm to cash flow his operation.

5. Commodity Prices - the only real solution to our debt problem is increase commodity prices. You can't borrow your way out of debt and you can't sell your commodities for less than the cost of production and continue to operate.

Thank you.

(Attachment follows:)

CHECKLIST FOR LENDERS
REVIEWING THEIR FmHA GUARANTEED LOANS

This checklist is not a substitute for the requirements outlined in applicable 7CFR part 1980 subparts A & B which governs the FmHA Guaranteed Loan Program.

1. Check the promissory notes to be sure of the following:

   a. The note amount cannot exceed $400,000 on an operating loan guarantee or $300,000 on a farm ownership loans.

   b. Payment of interest on interest is not permissible.

   (c) Payment on demand before default is not allowed.

   d. Late payment charges will not be covered by the Loan Note Guarantee of Contract of Guarantee.

   e. A "Line of Credit" is permissible only under a Contract of Guarantee.

   f. Maturity date may not exceed 7 years.

[illegible] demand note will not work

2. Check to see that loan funds were used for purposes approved by FmHA. The file should be documented to show the disbursement of the total amount of loan funds.

3. Check to be sure OL Funds were not used for:

   a. Purchase of Real Estate.

   b. Refinance of debts incurred for the purchase of real estate.

   c. Making of principal payments on real estate.

4. Ascertain that a lien search has been documented to show proper lien position.

5. Verify that there is documentation of a review of the loan requirements and agreements with the borrower prior to loan closing.

6. Is a formal "Borrower Loan Agreement" or "Line of Credit Agreement" on file and does the Agreement contain management and supervisory agreements as suggested in FmHA Instruction 1980.113 (d)(7)?

7. Verify that the borrower has marketable title to all of the collateral securing the loan.

8. Is the bank's interest charge a rate not to exceed one percent (1%) above the rate the lender charges to average farm customers.

9. Is there documentation of bank variable interest rate policy and noted changes? Is the base rate tied to a periodically published in an external or internal financial publication?

10. Is the lien coverage and lien priority as agreed to by FmHA recorded and being maintained?

(Bank Loan Review Checklist)

11. Check to see that the borrower is in compliance with the covenants and provisions of the: Note, Loan Agreement, Security Agreement, and any supplemental agreements. Is there documentation of actions to correct non-compliance?

12. If corrective actions in item #11 are not attained, has FmHA been notified within 30 days of the default on Form FmHA 1980-44?
Know definition of ~~[illegible]~~ work Default

13. Verify that adequate insurance is maintained such as; hazard, crop, life, liability.

14. Is the payment of: taxes, rents, assessments, and other payments that may affect collateral being documented?

[illegible] * 15. Is there a documented record of the proceeds from the sale of or other dispositon of collateral and are the funds being applied in accordance with the lien priorities on which the guarantee is based?

16. When the borrower is a corporation or partnership, are financial statements in the file from the loan guarantors. at least semi-annually

17. Has proper documentation been made and concurrence received from FmHA when a borrower has been released from liability for any part of the loan?

18. Was the FmHA Finance Office provided the loan status reports annually as of December 31st of each year on Form FmHA 1980-41, "Guaranteed Loan Status Report", with a copy to the FmHA County Office?

19. Are Financial Statements being obtained from each operating loan borrower at least semiannually?

20. Are annual Financial Statements obtained on each guaranteed farm ownership borrower?

21. Is the borrower's financial statement analysis and documented? Have servicing actions taken been documented? Have copies been provided to FmHA.

22. Are payments being applied to other unguaranteed loans prior to the guaranteed loans. (A prudent collection policy must be followed with documentation and justification.)

23. Are inspections of the collateral being done often enough to properly service the loan. Is there adequate documentation of the inspections? Is there a plan for inspecting the collateral and documenting the visits?

24. Is a current copy of FmHA Instruction 1980-A and 1980-B with attachments on file in the bank?

25. Does the bank have a supply of Form FmHA 1980-44, "Guaranteed Loan Borrower Default Status Report"? (There is a 30 day notification requirement to FmHA on non-compliance and defaults.)

26. Does the bank have a stated procedure for liquidating loans when corrective actions fail?

* An accurate and detailed disbursement - repayment record is critical. use form pg 27

Testimony on Behalf

of the

NATIONAL CATTLEMEN'S ASSOCIATION

NATIONAL ASSOCIATION OF WHEAT GROWERS

NATIONAL CORN GROWERS ASSOCIATION

NATIONAL COTTON COUNCIL OF AMERICA

NATIONAL GRANGE

NATIONAL PORK PRODUCERS CCOUNCIL

on

"The Agricultural Credit Crisis"

before

The Honorable Ed Jones, Chairman
Conservation, Credit and Rural Development Sub-Committee
of the House Agriculture Committee

submitted by

Cal Coulter, Vice-Chairman
National Cattlemen's Association
Tax and Credit Committee

April 9, 1986

Mr. Chairman, members of the Committee, my name is Cal Coulter. I'm a rancher from western Nebraska, and currently serving as Vice Chairman of the National Cattlemen's Association's Tax and Credit Committee. I am a former member of the board of directors for the Scottsbluff Nebraska Federal Land Bank Association. Today my statement expresses the views of the National Cattlemen's Association, the National Association of Wheat Growers, the National Cotton Council of America, the National Corn Growers Association, the National Pork Producers Council and the National Grange. We are here to demonstrate the concern of our member-producers who are the agricultural borrowers of this great country. The focus of this committee's efforts must be on providing assistance to the producer-borrower otherwise effectiveness and goal of any proposed legislation falls short.

The above mentioned group of agriculture commodity interests have been meeting to explore the agriculture credit problems since early 1985. On several occasions over this past year, the producer members of our various organizations have gathered in Washington. In the course of analyzing the farm credit crisis we have met with members of the Agriculture Committee, the Banking Committee and Appropriations Committee. To follow up on these Congressional visits, the groups met with the United States Department of Agriculture, Federal Deposit Insurance Coroporation, Office of Comptroller of the Currency, Farm Credit Administration, to access available regulatory measures. Furthermore, we continue to meet frequently with the Farm Credit System, the American Bankers Association and the Independent Bankers Association of America.

We must stress to the committee the importance of addressing the needs of borrowers and lenders alike. Efforts to rehabilitate lending institutions with no assistance for the producer-borrower does absolutely no good. We will continue to be available to work with all parties to resolve a situation that does require mutual effort.

Last fall, we worked closely with members of Congress as they labored to provide assistance for the Farm Credit System. Despite repeated assurances from the Administration as well as Farm Credit System officials to the contrary, our members are being denied operating credit and have experienced increasing foreclosure actions by the System and see their farmer-owned system shrinking. In 1984, their portfolio was $78 billion, by 1985 it was $66 billion with most analyst projecting additional losses this year.

Agricultural producers are suffering from a lack of affordable credit for both long and short term financing. Interest rates remain significantly higher in most rural areas of our country. In addition, we find our problems compounded by unstable or falling collateral values which provide the asset base for these loans. A serious problem indeed-interest rates that are unreasonably high and declining farm asset values.

This current lending season, the Farmers Home Administration has dramatically fewer funds compared to last year. Commercial lending institutions, which are becoming increasingly leery of extending agricultural credit, are pulling away from agricultural borrowers. Productive farmers and ranchers are finding themselves without commercial sources of credit and FmHA is falling short in its mission to provide transitional credit.

Recent changes in programs at FmHA were designed to provide some relief. However, the recent numbers indicate that the guarantee and interest rate buydown programs are a major disappointment.

Efforts to resolve these problems must focus not only on the lender but the borrower. Without helping both groups you fail to adequately address the problem. Legislation and regulatory changes should accomplish the following:

1) Strongly encourage restructuring loans while discouragimg foreclosure actions.

2) Provide incentives to lenders to practice forebearance policies.

3) Stress the importance of allowing farmers and ranchers to remain with commercial sources of credit. Community loan officers know their customers and their operations.

4) Remove the overbearing "dark cloud" of risk that has lenders artificially inflating interest rates.

5) Allow interest rate levels in agricultural regions to reach similar levels available to borrowers in urban areas.

6) The real solution to the credit crisis must be lower real interest rates to farm borrowers.

We want to compliment you in your efforts in this area Mr. Chairman. We will continue to work with you and this Sub-Committee. Our members recognize that the agriculture credit crisis will need your continued leadership as well as others in Congress. We are willing and ready to work with all interested parties to ensure that prompt action is taken to return stability and viability to our industry.

Thank you Mr. Chairman. I appreciate the opportunity to discuss these issues with you. This statement represents the views of a large number of agricultural groups. As a representative of the National Cattlemen's Association, I am now available to answer any questions you or the Committee might have.

NATIONAL FARMERS UNION

STATEMENT OF PAUL R. SACIA
ASSISTANT DIRECTOR OF LEGISLATIVE SERVICES
NATIONAL FARMERS UNION

PRESENTED TO

CONSERVATION, CREDIT AND RURAL DEVELOPMENT SUBCOMMITTEE
OF THE
COMMITTEE ON AGRICULTURE
U. S. HOUSE OF REPRESENTATIVES

REGARDING

ABILITY OF AGRICULTURAL LENDERS TO PROVIDE
ADEQUATE CREDIT TO FARMERS

APRIL 9, 1986

My name is Paul R. Sacia. I am the Assistant Director of Legislative Services for the National Farmers Union, a general farm organization representing the views and interests of some 300,000 farm and ranch families throughout the United States.

As always, Mr. Chairman, you have been extremely accessible and accommodating in allowing the views of farmers to be heard during these trying times. We are most appreciative of your leadership.

Today this Subcommittee will hear from many organizations, all in some way verifying the magnitude of the farm crisis. We will focus on that aspect, and we would also like to discuss what can be expected from us as a general farm organization during this period. During such highly-charged times, it seems important for all parties involved in this policy-making process to have their perspectives completely understood.

First, NFU President Cy Carpenter has made it clear that this organization will continue to tell of the despair and anger of our farmers and ranchers, no matter how negative that might sound to some ears. We are absolutely beholden to our members to tell their story, and that story is getting uglier every day.

To those that claim that anyone who sharply criticizes U.S. farm policy is politically motivated, we would simply respond that anyone who remains silent as they witness the administration of the most failed farm policy in American history should be the first to have their motivations questioned for letting politics stand in the way of reason.

Mr. Chairman, our organization has never deviated from the belief that supply management, fair prices and international cooperation in trade are essential for workable agricultural policy; and several decades of stable, prosperous agriculture back up our conviction.

This hearing today is important because we can begin to respond in kind to the severity of the farm depression. We need to get the wheels of agricultural credit turning again in order to "buy time" for farmers as they wait for farm income to be restored. A quick telephone sampling of some of our state organizations only adds to well-established fact that chaos now reigns in much of rural America as farmers battle for credit to stay afloat one more year.

From Minnesota:

Our state president estimates that a third of all Minnesota farmers still do not have financing for this spring.

From Illinois:

Our state president told us that he "has heard three times more cases of farmers going out of business than the previous year. Unlike last year, when many farmers obtained credit at the last moment, the belief is that last moment credit is not forthcoming because lenders have lost all faith that another year will bring any change."

The Illinois Farmers Union office reports the Federal Land Bank has foreclosed on farmers financed at 12½% interest and the bank then sells the farm land to another buyer at 8% interest, requiring no stock, no up-front points and guaranteeing the 8% financing for five years.

From South Dakota:

Our people report that between 30% and 40% of the farmers are having difficulty securing credit, with 10-15% not able to secure any credit at all.

They report that the Internal Revenue Service is attempting to tax capital gains on farms that have been foreclosed upon. Farmers with absolutely nothing left financially are having to resort to bankruptcy to avoid IRS capital gains taxation.

From Colorado:

Our people believe that about 40% of the farmers and ranchers are not receiving the necessary credit. In parts of western Colorado, of about 500 farmers, only 10% have received credit at this point.

From Iowa:

Our state president estimates that between 20% and 30% of the farmers are not receiving financing; and in south-central Iowa, that figure is as high as 50%.

From North Dakota:

Government statistics indicate that 37.8% of North Dakota farmers are in the financially-distressed category, that is, they have a debt-to-asset ratio of 40% or more. Another 14.7% of the farmers fall under the 70% debt-to-asset ratio, over 4,000 farmers in extreme danger of losing their farms.

North Dakota FmHA last year used $168 million of direct operating loans. This year $57 million has been allocated, with $87 million already used.

North Dakota reports that $9.6 million worth of approved loans have not been funded, with $1 million to $1.5 million worth of loan applications coming in every day. This rate of application for loans is expected through the remainder of April.

We believe that the real need for direct operating loans is again near last year's level of $168 million.

Such appraisals simply underscore some of the contributing factors to a general mood of despair and frustration in rural America. And three months after the farm bill was passed, where are the experts and economists to be found who believe that the principal objectives of regaining U.S. competitiveness in global food trade while reducing crop stockpiles and preserving farm income will be met in the near future or at any time.

These farm families deserve to have some hope. If ever there was a time for Congress and the Administration to be bold, this is it. The Farmers Union is not asking for any more band-aid approaches for this wound, so self-inflicted by federal policy. A tourniquet needs to be applied immediately in the form of substantial credit legislation to stop the hemorrhaging and then we need to turn our sights on the prime issue of increasing farm income.

We commend Representatives Bedell and Daschle and the other co-sponsors for their bill, H.R. 4267, the Emergency Farm Income and Credit Bill of 1986. We believe it is bold legislation which addresses both the emergency credit and farm income side of the equation.

We support the concept of providing a 90% FmHA loan guarantee to lenders for the purpose of restructuring existing agricultural loans. We especially like the idea that the interest buydown provisions of this bill will encourage lenders to write-off additional unproductive debt beyond the minimum 10 percent.

While we enthusiastically endorse H.R. 4267, we would like to make the credit portion more far-reaching, that is why NFU is also supportive of another credit package, the Fair Credit Plan which is complimentary to H.R. 4267.

The reason we believe legislation of this type to be essential rests upon one frightening finding by the Department of Agriculture. As of January 1, 1985, USDA showed that one-half of the family-sized commercial farms experiencing financial stress had no income at all left for loan payments after paying farm operating and family-living expenses. Of course, with another 15 months passing, things have only worsened. We are concerned that various debt-restructuring proposals, no matter how well intentioned, are inadequate in assisting farmers whose debt-to-asset ratios exceed the 70% level.

As in the Bedell/Daschle bill, attention would be directed to the underlying course of the farm crisis -- depressed income. The first year's government outlay would be approximately $1.7 billion, given current commodity prices. If, for instance, prices were to be set at reasonable rates of around $5.00 per bushel for wheat and $3.60 per bushel for corn, with accompanying production set-aside programs, the program costs would be reduced immediately by about 60%. With what is at stake, this is not an unreasonable investment.

Under the Fair Credit Plan:

* Lenders would remain solvent; money would be lost in writing down the loans, but they stand to lose much more under current circumstances.

* Family farmers in trouble would remain in business. Some would lose land in partial repayment of their debts, but they would still be operating a viable farm, with manageable loan payments. (The lenders' plans that we have seen all assume a large proportion of distressed farmers would lose their operations.)

* Thousands of farm foreclosures would be prevented, thereby stabilizing land and equipment markets, slowing the downward spiral of prices that is reducing the assets of all farmers.

We are highly supportive of the mediation provisions of this bill. The relationship between farmer and lender is becoming more combustible by the day. Our national convention called for mediation procedures outside of government auspices, however, this mechanism is very acceptable under the format of the Fair Credit Plan.

The deferred payback provisions of this bill are key. The farmer's payback to the government of money advanced during the emergency would be deferred until farm income rose to the point that he could afford to begin repayment. Again, this way, outlays would be directly linked to commodity prices and other determinants of farm income.

Mr. Chairman, it is safe to say we all make mistakes. By the nature of the business, farmers take chances and make mistakes and then must swallow their pride and make the necessary adjustments in their operations to stay viable. A mistake has been made in agricultural policy in this nation. The evidence is irrefutable, and we can't afford to play this scenario out just for the sake of pride, because it's economically and emotionally destroying thousands of families, as well as eating away at the infrastructures of our rural communities.

We are urging America's farmers to fight back; that we will do all we can to help them keep their farms. We feel it is so important to turn their despair into hope, but ultimately that hope must come from you. We encourage you to support H.R. 4267 and the Fair Credit Plan.

Thank you for your time and consideration.

Statement to the Subcommittee on Conservation, Credit and Rural Development of the Committee on Agriculture, U.S. House of Representatives
April 9, 1986

Cecil W. Huff
Co-Chair, National Farmers Fair Credit Committee
Route 4 Box 113
Ava, Missouri 65608

Mr. Chairman and Members of the Subcommittee:

My name is Cecil Huff, and I am a dairy farmer from Ava, Missouri. I am Co-Chair of the National Farmers Fair Credit Committee, a committee of the National Save the Family Farm Coalition. Our Committee is a coalition of over 70 grassroots farm and rural organizations from 18 states who have come together to find an equitable solution to the debt crisis facing family farmers.

The Committee has identified 3 principles that we believe must be part of a plan that adequately addresses the farm debt crisis. Those are:

1) That it be targetted to family farms and that the central focus be to save as many farmers from losing their farms as possible.

2) That it works to keep both lenders and farmers solvent, but helps lenders by helping farmers first.

3) That it be linked in some way to the ultimate goal of raising farm commodity prices to a fair and livable level.

The National Farmers Fair Credit Committee has spent the last several months writing our own plan that adheres to the principles I just laid out. Our plan, now in bill form, is called the Fair Credit Plan, which I would like to talk about today.

Before I speak specifically about our bill however, I need to impress upon the members of the Subcommittee the seriousness of the crisis today, and the need for immediate and adequate action.

In my state, and in the 17 other states we have groups in, the story is the same. The farm crisis hotlines we have in each state constantly ring off the hook, with desperate farmers, both young and old, calling for help. The stress is mounting as families struggle to put a crop in, while carrying huge and growing debt loads and trying to keep their children fed and clothed. It isn't just a few poor managers being squeezed out in a move towards greater effeciency. We are losing our brightest and best educated farmers. Our older farmers, through foreclosure or involuntary conveyence of property, are losing a lifetime of labor and their life's savings with the stroke of a pen. These older farmers were considered as morals pillars in society and oftentimes, men of wisdom. Now they are faced with becoming society's new poor.

I won't dwell on statistics, but one striking fact about the extent of financial distress facing family farmers is this: based on the latest USDA figures, one half of family-sized commercial farms experiencing financial stress have no income at all left for loan payments after paying farm-operating and family-living expenses. It is alarming fact that has a significant impact on the effectiveness of most of the proposals for emergency debt relief that are being discussed.

There are several proposals being discussed today that propose to restructure debts with a combination of lender foregiveness and government assistance to write down loan principles and interest rates. But all have a common flaw--as the latest USDA statistic that I mentioned make clear, the financial condition of a very large fraction of the farmers in trouble is so serious that for them this approach would fail.

With each of these proposals, there is an underlying assumption that we just cannot save everyone. There are just some farmers that will have to go under. In light of the financial condition of over half the family farmers introuble however, the some farmers that can't be saved turns out to be a substantial number. These plans just do not offer adequate relief if the goal is to save our family farms.

That is why we are proposing the Fair Credit Plan. It is a comprehensive debt relief plan that really speaks directly to the issue of saving most of our family farmers in trouble today.

The Fair Credit Plan would be a federally-funded, state-administered emergency response to the financial crisis in agriculture. The major features of the bill are that it applies to all agricultural lenders, including individuals who finance farmers. No one is left out. It is targetted only to family farmers who need assistance the most. It also keeps decisions about farmer's financial situation at home, instead of the loan being sent to a national Capital Corporation.

This is how the Fair Credit Plan would work. A farmer would be eligible if he was a family-sized operator, had a debt to asset ratio greater than 40%, and showed negative cash flow. Once a farmer was declared eligible for assistance under this program, he would be protected from foreclosure or repossession of his property, pending the result of a state-administered mediation process. From the beginning, the farmer would be required to pay his lenders what he could afford to pay, as determined by an independent state evaluation.

The lender would restructure the farmer's debts with a principle writedown of 30% and interest writedown to 10%. If what the farmer could afford to pay was still less than his restructured annual loan obligations, the government would advance to the farmer enough money to make up the difference, up to $30,000. The farmer's payback to the government of the cash advance would be deffered until farm income rose to the point that he could afford to begin repayment. In this way, the annual government outlays under the Fair Credit Plan would be directly linked to commodity prices and other determinants of farm income.

In summary, I feel that the farm debt crisis will never be accepted by farmers the way a natural disaster would. Farmers will never accept what is happening, because this is a man-made problem, it has been forced upon us, and what's more, we can see how it can be fixed.

Thank you for your time.

(Attachment follows:)

THE FAIR CREDIT PLAN

***************** NATIONAL FARMERS' FAIR CREDIT COMMITTEE ****************

The Fair Credit Plan would be a federally-funded, state-administered emergency response to the financial crisis in agriculture. The farmers' crisis has become a lenders' crisis as well. Unfortunately, the proposals for federal or state action receiving most attention are either blatantly unfair or woefully inadequate.

"Loan warehouse" approaches would use government money to rescue one of the two groups in trouble, the agricultural lenders, but sacrifice the other group in trouble, the family farmers. Proposals to facilitate debt-restructuring negotiations between farmers and their lenders, with a combination of lender foregiveness and government funds to write down loan principals and interest rates all have a common fatal flaw--as the latest USDA statistics make clear, the financial condition of a very large fraction of the farmers in trouble is so serious that for them this approach would fail.

The Fair Credit Plan would help both family farmers and agricultural lenders in trouble today. And, through its deferred government payback provision, it would direct public attention to the fact that raising farm commodity prices is a necessary condition for solving the financial crisis in agriculture.

BASIC ELEMENTS OF THE PLAN

The Fair Credit Plan would be targetted at family-sized farms only and have seven basic elements:

I. FORECLOSURE PROTECTION: Once a farmer was declared eligible for emergency assistance under this program, he would be protected from foreclosure or repossession of his property, pending the result of a state-administered mediation process.

II. FARMER PAYMENTS: From the beginning, the farmer would be required to pay his lenders what he could afford to pay, as determined by an independent state evaluation.

III. LENDER WRITEDOWN: The lenders would restructure the farmer's debts with principal and interest writedowns in accord with guidelines established by the legislation.

IV. GOVERNMENT OUTLAY: If what the farmer could afford to pay was still less than his restructured annual loan obligations, the government would advance to the farmer enough money to make up the difference.

V. LOCAL MEDIATION: Local mediation procedures would insure that the particular circumstances of individual farmers and lenders were taken into account and dealt with fairly.

VI. DEFERRED PAYBACK: The farmer's payback to the government of the money advanced during this emergency would be deferred until farm income rose to the point that he could afford to begin repayment. In this way, the annual government outlays under the Fair Credit Plan would be directly linked to commodity prices and other determinants of farm income.

VII. STEWARDSHIP OBLIGATIONS: Farmer participants would agree to take on prescribed land stewardship obligations, as they become financially possible, including implementation of a soil-loss reduction plan.

AN EXAMPLE

A 320 acre grain farmer has a total outstanding debt of $200,000. Under the Fair Credit Plan, his lenders would agree to write down the debt by 30% to $140,000. Suppose the farmer could only service $40,000 of that debt. Then he would be eligible for a government loan of $10,000 to pay the 10% interest on the remaining $100,000. Commodity prices remain the same the next year, so he receives another $10,000 government loan. The lenders are paid the interest on the debt, but the farmer's payback to the government is deferred. Suppose that Congress then passes legislation that increases corn prices by $1.00, with a 20% mandatory cutback in production. The cash this farmer has available for loan payments would increase from about $4,000 to about $29,000. In the third year, he would not only make full loan payments to his lenders, but he would also begin to pay back the government.

WHY THE FAIR CREDIT PLAN IS NEEDED

Statistics compiled by the U.S. Department of Agriculture on the financial condition of farmers make clear why the alternative proposals are inadequate and the Fair Credit Plan is needed. As of January 1, 1985, the latest figures released, there was a striking fact about the family-sized commercial farms experiencing financial stress: After paying farm-operating and family-living expenses, approximately one-half of these farm families had no income at all left for loan payments. And that was a year ago; in the meantime, commodity prices have declined even further.

What this shows directly is that proposals to help those tens of thousands of family farmers in trouble by writing down their debts and/or their interest rates will not be enough. A great majority of them will still be unable to meet their loan obligations. So these debt-restructuring proposals, no matter how good they sound and no matter how well-intentioned their proponents, are inadequate to cope with the seriousness of this emergency. For most of the family farmers in trouble to survive this crisis, a temporary government loan of additional money to make up the difference between what the farmers can afford to pay at today's commodity prices and the written-down debt payments will be required. That is the essence of the Fair Credit Plan.

OUTCOMES OF THE FAIR CREDIT PLAN

- The lenders in trouble would remain solvent; they would lose some money in writing down the loans, but not nearly as much as they stand to lose under the present circumstances. In this sense, the outcome for lenders would be much the same as under the proposals some lenders have been lobbying for in Washington, which would use federal funds to reduce to acceptable levels the losses they would suffer if they foreclose on farmers.
- The family farmers in trouble would stay in business; they would incur land stewardship obligations and possibly lose some land in partial repayment of their debts, but they would retain a viable farm, with manageable loan payments. In this sense, the outcome for farmers would be much more just than under the lenders' plans, in which a large proportion of the farmers in trouble would lose their farms.
- Other farmers, small business people and rural residents in general would also benefit. By preventing many farm foreclosures, this plan would stabilize land and equipment markets, stemming the slide of prices that is reducing the assets of all farmers. And the survival of rural communities is tightly linked to the survival of family farms.
- Attention would be focussed on the underlying cause of this crisis--depressed farm income due, in large measure, to farm commodity prices well below the cost of production. The government, which would be making a large annual outlay for the Fair Credit Plan, would acquire a highly visible stake in the profitability of agriculture.

ESTIMATED GOVT. OUTLAY FOR A FCP TARGETTED ON FAMILY-SIZED FARMS

The annual government outlay would depend on many factors, including the farm commodity prices and the lender writedown of principal and interest rates. For instance, assuming 1985 commodity prices, a 20% principal writedown and 10% interest rates, the first-year Fair Credit Plan outlay to help all family-sized commercial farms in trouble would be about 1.7 billion dollars for the U.S. as a whole and 140 million dollars for one large agricultural state, Minnesota. What is particularly striking is how much the annual government outlay would decrease if commodity prices were to rise even a modest amount. For instance, if Congress were to pass Harkin-type legislation leading to $3.60 a bushel corn, with a 15% mandatory cutback in production, the annual government outlay for the Fair Credit Plan would drop by 65% to $600 million dollars.

For More Info:

Family Farm Organizing
Resource Center
2395 University Ave. #202
St. Paul, MN 55114
(612) 645-1231

FIRST YEAR OUTLAY

	D/A Between 40% and 70% and Negative Cashflow			D/A Greater Than 70% and Negative Cashflow		
Sales Class	# of Farms	Ave. Loan	Loan Total (Mil.)	# of Farms	Ave. Loan	Loan Total (Mil.)
$40,000 to $100,000	27000	$11,200	$302	35000	$14,000	$492
$100,000 to $250,000	14500	$19,700	$286	25000	$24,100	$602
TOTAL = ($302 + $492 + $286 + $602) million = $1.68 billion						

A FAIR CREDIT PLAN TO SAVE THE LENDERS AND THE FARMERS

Statement to the Subcommittee on Conservation, Credit and Rural
Development of the Committee on Agriculture, U.S. House of Representatives
April 9, 1986

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Program in Science, Technology and Public Policy
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Mr. Chairman and Members of the Subcommittee:

I am pleased to have the opportunity to testify before you today on behalf of the Fair Credit Plan and to contrast it with other emergency agricultural credit proposals you will be considering.

Most of the proposed emergency credit plans have an element in common, as shown in the first chart. The lenders write down the farmer's debt somewhat, taking a loss in the process. But the loss is much less than the unacceptable loss they face if they have to foreclose on farmers and, eventually, sell the land and equipment they acquire. With the addition of provisions that would allow the lenders to write off their agricultural losses over several years, the lender losses become acceptable and the lenders' solvency is protected.

After the lender writedown, however, there frequently remains a gap between the written-down debt and the debt the farmer-borrower can cash-flow. That is where the federal government comes in and that is where the various proposals differ significantly They have very different "gap philosophies," resulting in very different outcomes for farmers in trouble.

To aid you in assessing the desirability of the emergency plans you will be hearing about today and in the coming weeks, I wish to propose a critical test. You should ask the proponents of each plan to answer clearly and directly the following questions: How many of the family farmers in trouble today will be saved by the emergency credit plan you propose? How many will lose their farms?

Do not be satisfied with vague replies like, "Of course, not all of the farmers in trouble will make it." What you will find if you probe more deeply is that some of the proposals receiving the most attention so far would amount to a triage policy for the American family farm. The "some of the farmers who won't make it" under the terms of those proposals would be a third or more of the commercial family farms.

Of course, it will take careful analyses to answer in detail the question I propose. But some general effects are easy to spot. Statistics compiled by the U.S. Department of Agriculture on the financial condition of farmers make clear why the alternative proposals are inadequate and the Fair Credit Plan is needed. As of January 1, 1985, the latest figures released, there was a striking fact about the family-sized commercial farms experiencing financial stress: After paying farm-operating and family-living expenses, approximately one-half of these farm families had no income at all left for loan payments. And that was a year ago; in the meantime, commodity prices have declined even further.

So, for many of the family farmers in trouble today, the cash-flow situation is not really like that shown in the first chart. Rather, it is like that shown in the second chart.

What this demonstrates directly is that proposals such as those of Minnesota Senator Boschwitz, Oklahoma Senator Nickles, or Iowa State economist Neil Harl that purport to help those tens of thousands of family farmers in trouble by writing down their debts and/or interest rates will not be enough. A great majority of them will still be unable to meet their loan obligations. So these debt-restructuring proposals, no matter how good they sound in priciple and no matter how well-intentioned their proponents, are inadequate to cope with the seriousness of this emergency. For most of the family farmers in trouble to survive this crisis, a temporary government loan of additional money to make up the difference between what the farmers can afford to pay at today's commodity prices and the written-down debt payments will be required. That is the essehce of the Fair Credit Plan.

One proposal that deserves special comment is the debt-restructuring part of the Bedell-Daschele bill. That proposal and the Fair Credit Plan have the same "gap philosophy." The gap that remains between the debt the farmer can cash-flow and the written-down debt must ultimately be closed by an increase in farm income if our family farms are to survive.

If farm commodity prices go up significantly this year, as in the price part of the Bedell-Daschele bill, then the credit part of that bill, in which lenders write down farmers' debts to level thay can cash-flow, makes sense. With higher commodity prices, the writedown to farmer cash-flow levels would be tolerable to lenders. But if commodity prices do not go up this year, a lender writedown to the level many farmers can cash-flow now would impose an unacceptably heavy burden on the lenders.

The Fair Credit Plan would limit the lender writedowns to acceptable amounts, whether commodity prices go up this year or not. At the same time, it would keep farmers on the land through a loan to fill the gap temporarily, until commodity prices go up.

In summary, then, the Fair Credit Plan would help almost all the family farmers and agricultural lenders in trouble today. In contrast, most of the alternative emergency credit bills are either blatantly unfair or woefully inadequate. Some are targetted to rescue one of the two groups in trouble, the lenders, but sacrifice the other group in trouble, the family farmers. Even those aimed at helping farmers would result in a substantial fraction of the family farmers in trouble today losing their farms. While the Bedell-Daschele bill shares the Fair Credit Plan's "gap philosophy," unlike the Fair Credit Plan, it cannot stand alone as emergency credit legislation if its provisions fail to pass this year.

(Attachments follow:)

CHART #1

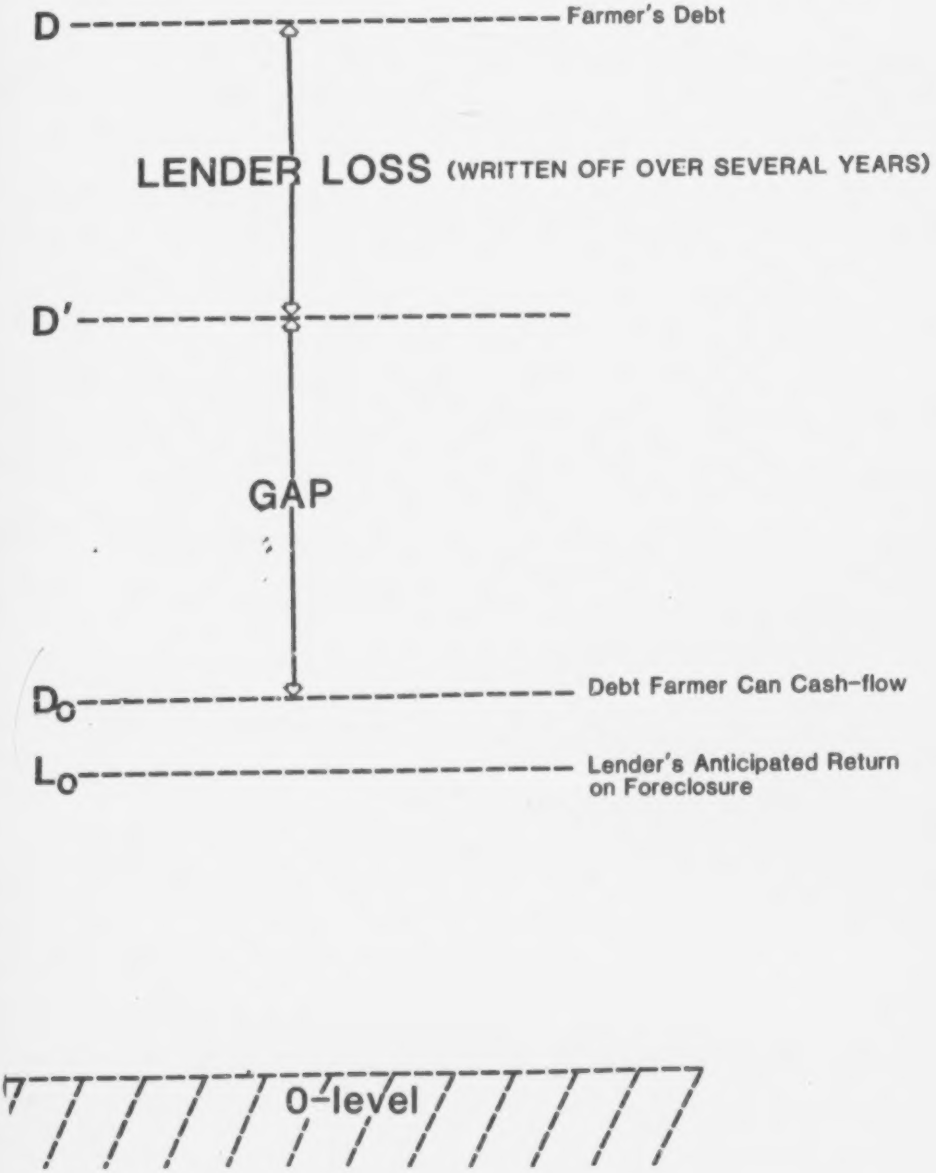
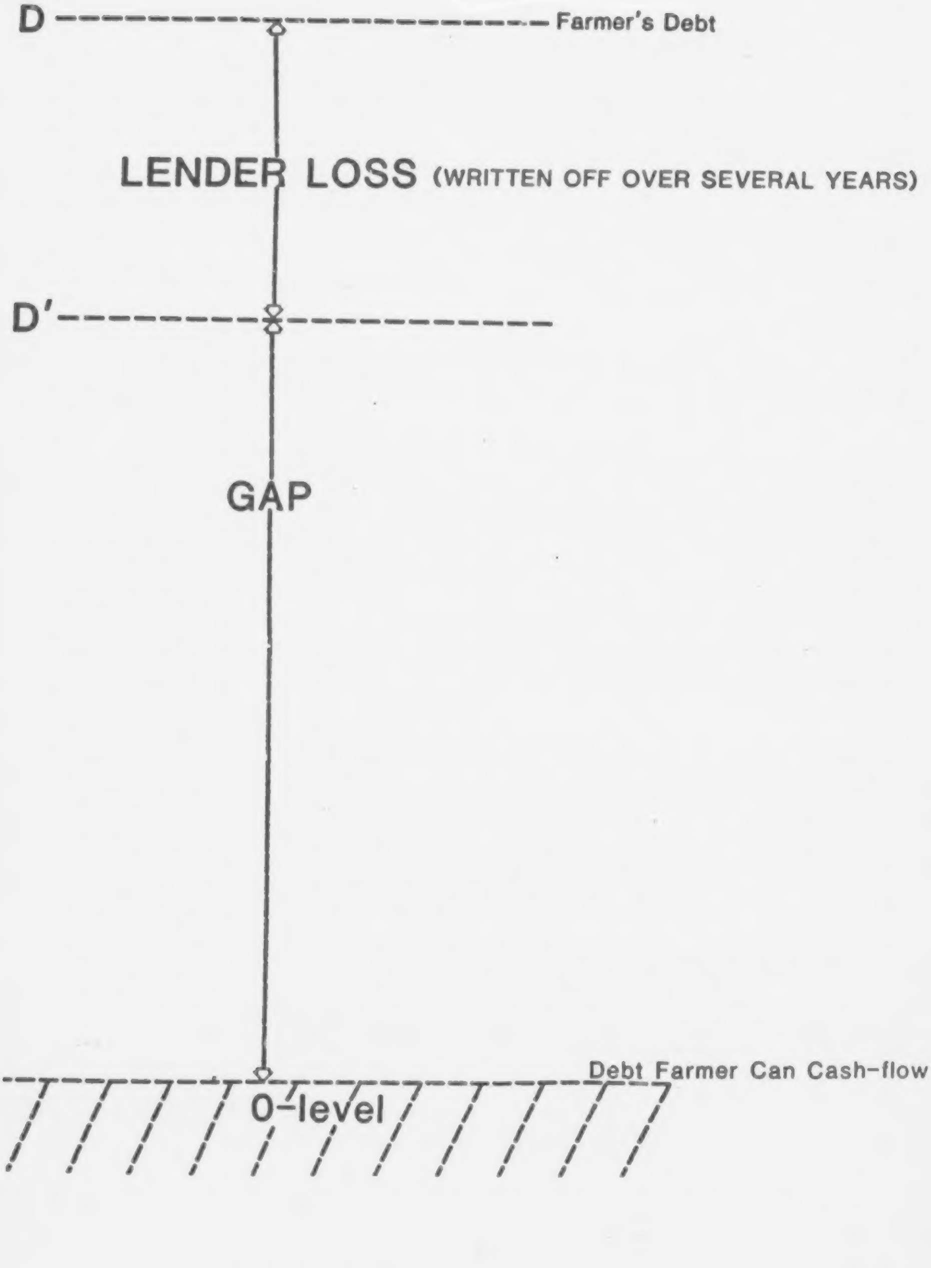

D
Farmer's Debt
LENDER LOSS (WRITTEN OFF OVER SEVERAL YEARS)
D'
GAP
D_0
Debt Farmer Can Cash-flow
L_0
Lender's Anticipated Return on Foreclosure
0-level

CHART #2


D
Farmer's Debt
LENDER LOSS (WRITTEN OFF OVER SEVERAL YEARS)
D'
GAP
Debt Farmer Can Cash-flow
0-level

FINANCIAL ADJUSTMENT REQUIREMENTS FOR COMMERCIAL AGRICULTURE

Testimony Presented to:
Subcommittee on Conservation, Credit,
And Rural Development

April 9, 1986

ROBERT W. JOLLY, PROFESSOR OF ECONOMICS
Iowa State University

INTRODUCTION

U.S. agriculture is in transition -- attempting to move between two distinct states of the national economy. For perhaps a third of the U.S. farmers, the change from an inflationary to a deflationary environment has left debts that are unsupportable at projected levels of income and rates of interest. For these farmers, change is inevitable. Improved cost efficiency or more generous price support programs may ameliorate the extent of change required. However, their long term viability will generally require reduction and restructuring of debts and assets. If profitability cannot be restored through financial restructuring, these farm businesses will, eventually, fail.

A number of policy proposals are now being presented that attempt to facilitate this transition. Specific proposals call for interest rate subsidies, loan guarantees or land holding-tanks. Most of these proposals are untested and have few analogs in the fifty-year old complex of commodity programs. Often the objectives of these financial intervention programs seem unclear. Certainly their cost and efficacy remain in doubt.

The purpose of this paper is twofold. First, we summarize the current financial condition of farmers. Second, we estimate the likely adjustment which the agricultural sector must make in order to achieve some degree of short-run financial stability. The impact of various income levels and asset market conditions on this restructuring requirement are also to be examined.

U.S. Farm Financial Conditions - 1985

The current farm financial problems appear, at first glance, to be widespread and fairly uniform among farm families. This is not the case. Some farmers are earning acceptable incomes and rates of return. Others are failing utterly. These differences make public financial policy difficult to design and even more difficult to administer.

Another characteristic that makes the farm financial problem difficult is that it possesses both human and financial dimensions. Farm financial stress is a human problem. It affects a definable group within the farm population. As with any crisis, financial stress causes suffering and pain. There is a financial side as well. Financial and farm asset markets are not performing well. Many institutions ranging from county seat banks and grain elevators to the Farm Credit System seem to be in jeopardy. Although the human side of this crisis gets some play in the press, it is the financial dimension that receives the attention of policymakers.

Incidence and Relative Frequency of Financial Stress

Measuring financial stress is not straightforward. In the short-run, a negative cash flow can indicate stress. It may also reflect expansion or a routine buildup in grain or livestock inventories. The debt-to-asset (D/A) ratio has been widely used as a measure of stress. Normally the D/A ratio measures solvency. However, it can also be used as a rough measure of liquidity. With rates of return to owned assets currently averaging 6 to 7 percent and debt service costs (principal and interest) averaging 15 to 16 percent, farmers with a D/A ratio exceeding 40 percent would be expected to have negative cash flows.

Insolvency is the extreme measure of stress. When a farm's debts exceed the value of its assets, in most cases, it will fail and cease operation. However, the insolvency rate is not a good leading indicator of financial problems.

Table 1 gives the proportion of farms occurring in these three stress categories for the U.S. and ten regions. These estimates are based on data from the USDA's Farm Costs and Return Survey (FCRS). These data reflect January 1985 conditions.

- Slightly more than 50 percent of U.S. farm operators in 1984 failed to generate a positive cash flow. In other words, farm and nonfarm income could not meet all cash obligations including debt service.

- Over 18 percent of farmers in the U.S. had D/A ratios over 40 percent. Nearly 3 percent were insolvent.

- Financially stressed farmers were most common in the Lake States, Corn Belt and Northern Plains. For the most part this reflects the distribution of farm operations in the United States.

- In relative terms, a greater proportion of farm operators were experiencing cash flow problems in the Northeast and the Delta.

- Farmers with high D/A ratios, including insolvent operations, were relatively more common in the Corn Belt, Northern Plains and the Delta.

- Appalachia, Southern Plains and Mountain States showed average or above average proportions of farmers with cash flow problems. However, insolvency and high D/A ratios seem significantly less than in the Midwest.

One commonly held belief is that farm debt problems primarily affect large high-rolling operations or midsized, inefficient farms. Table 2 reports the frequency of financial stress by annual sales class categories.

- The size composition of the farm population defined by the FCRS is given in the column headed Total Farms. Over 60 percent of the population has annual sales less than $40,000. In terms of corn production, this would be a farm less than 120 acres.

- The frequency of financial stress follows the farm size distribution closely. The most common farm size with cash flow or solvency problems is a small part-time operation.

- In relative terms some differences between small and large farms are evident. Small farms tend to experience relatively more cash flow problems. Larger farmers, on the other hand, show proportionally a much greater frequency of high leverage and insolvency.

Severity of Financial Stress

The severity of financial stress in the United States cannot be directly inferred from Tables 1 and 2. A farm firm's earned equity growth rate (EGR) can provide an approximate measure of the severity of financial stress. The equity growth rate, in this analysis, is calculated by dividing the firm's value of earned equity growth by its current net worth. The dollar growth in earned equity is equal to net cash farm income plus off-farm income less family living expenditures. If positive, this money is available to reduce principal, replace capital equipment, expand, or as a risk reserve. If negative, the shortfall is either added to debt or discharged by the lender. In this ratio form, the magnitude of the equity gain or loss is expressed relative to the size of the farm's net worth.

In Table 3 five EGR ranges are defined. Farms with an EGR less than -20 percent are losing over 20 percent of their equity from earnings alone. With declining asset values, farms in this category are extremely vulnerable to financial failure. Insolvent firms are also included in this category. Farms with an EGR from -20 to -5 percent are likely experiencing serious financial difficulties. Interest is continuing to accumulate and principal payments are being made. Farms with an EGR from -5 to +5 percent are in limbo. They cannot replace equipment or meet all principal repayment requirements. With an EGR from +5 to +20 percent the farm business is showing reasonable progress. Equity may still fall due to declining asset values. However, the farm's earnings are satisfactory. A farm with an EGR exceeding 20 percent would, at first glance, seem exceptional. This high EGR may be due to a very high earnings on assets. However, it may also be due to a small positive income combined with an even smaller net worth.

The distribution of farm operators -- their debt and assets among the five EGR categories -- is given in Table 3. Several key results need to be indicated:

- For the U.S. 15 percent of the farm operators are insolvent or have an EGR less than 20 percent. These farmers control nearly 28 percent of U.S. farm operator debt and 8.8 percent of farm assets. In general this group will be unlikely to survive.

- At the other extreme, 15.5 percent of farm operators had an EGR exceeding 20 percent in 1984. This group controls 14.7 percent of the debt and 10 percent of the assets.

- Combining firms with an EGR less than 5 percent, 60.9 percent of the operators controlling 64.1 percent of the debt are likely to experience financial stress and need to make operating changes to remain viable.

- In relative terms, the Corn Belt and Lake States show fewer farmers in the -20 percent EGR groups and more in the +20 percent groups.

- In the Delta, Southern Plains and Southeast more operators are experiencing severe financial stress compared with the national average. Further these farmers owe 30 percent of the regional farm debt.
  ine Pacific States show a very high concentration of debt, 35 percent, held by relatively few severely-stressed farm operators.

In Table 4, we look at the severity of financial stress as a function of farm size.

- The largest farm sizes have the greatest proportion of both high income and high stress farms.

- Farmers with annual sales under $100,000, show relatively few high EGR farms. The concentration of debt in stressed operations is greater than average for these small farms as well.

- Financial stress affects all size categories. In terms of the sector, more debt and assets and fewer operators are in the larger sales category.

Characteristics of Farm Operators

The FCRS data set contains relatively little demographic data on farm operators. Table 5 reports characteristics of Iowa farm families by D/A class. These data were collected in early 1985.

- The low debt Iowa farmers tend to be older, operate smaller acreages and have fewer dependents.

- Education level does not seem to be greatly affected by D/A class.

- The largest farms in terms of assets and acreage are in the 40 to 70 percent D/A group.

- The distribution of farm operators, their debt and assets among D/A groups parallels the national data. Iowa farmers with D/A ratios over 40 percent control over 70 percent of the operator debt.

The rapidly falling asset values have dramatically changed the financial condition of Iowa farmers in just a year's time. Table 6 gives the percentage change between 1984 and 1985 in the balance sheet for farmers within a given D/A group.

- The sample average showed a loss in asset value of 17.7 percent -- roughly equal to the decline in land values. Debt levels increased slightly, but non-real estate debt increased and real estate debt declined. Overall, equity fell nearly 25 percent in one year.
- Farmers in the 40-70 percent D/A group experienced moderate to severe stress. Changes in their average balance sheet followed the sample average. However, equity fell 34.5 percent.
- The high-debt farm operators in the 70-100 D/A group lost over 88 percent of their equity in one year. This occurred despite their attempts to reduce debt. Falling asset values and partial liquidation were the likely culprits.
- Farms that were insolvent in January 1984 increased non-real estate debt during the year. Asset values declined. Net worth, already negative, fell an additional 62 percent.

Farm-Level Adjustments to Financial Stress

Data presented in this report suggest that up to two-thirds of the farm debt in the United States is held by farm businesses experiencing financial stress. This is clearly an unstable situation. In the short-run, farms may adjust by attempting to increase productivity, by reducing costs or by reducing principal repayment. In the longer run, farm operations will need to adjust enterprises and in many cases restructure assets and liabilities. Financial restructuring involves selling assets, reducing debts and, in some situations, renegotiating principal balances with lenders. The restructuring process takes time. For some farm businesses, the adjustment is relatively minor. For others, so much of the asset base must be sold that the firm will likely fail before the restructuring can be accomplished.

Restructuring requirements for financially stressed farm businesses were estimated from Iowa Farm Finance Survey data. The average farm in 40-70 and 70-100 D/A group was restructured using three common techniques. A scale-back assumes the farmer sells assets, retires debt and reduces the size of the business. A sale-leaseback assumes assets and associated liabilities are liquidated, but the assets could be leased from an investor at prevailing rates. Debt discharge assumes the lender writes off sufficient debt to produce a positive cash flow.

The results of this analysis are presented in Table 7 for three income levels. At current income levels, the average 40-70 percent D/A producer shows a negative cash flow of $-11,400. Using a scale-back, a positive cash flow could be produced by selling 28.6 percent of the firm's owned assets. Over 44 percent of the debt would be reduced. A sale-leaseback reduces the extent of liquidation required to 21.5 percent. If the lender would discharge 20 percent of the debt -- about $72,000 (Table 5), the business would have a positive cash flow. The results in Table 7 suggest:

- For moderate debt operations and current income levels, liquidation requirements are extensive but generally feasible.

- Changes in income levels have a significant impact on the extent and feasibility of restructuring for this moderate debt group.

- Debt discharge, in general, offers only a partial solution to restructuring problems.

- For high-debt farms, in the 70-100 percent D/A group, all restructuring options seem nearly infeasible. The prospect of liquidating 70 to 80 percent of a farm's asset base with a lease-back seems fortuitous at best. Farmers in this group, in general, are living on borrowed time.

RESTRUCTURING REQUIREMENTS FOR THE AGRICULTURAL SECTOR

The restructuring requirements for an individual firm describe the general changes which the agricultural sector must make in order to bring debt levels in line with asset values and their earning capability. However feasible adjustment strategies for individuals may be unworkable in the aggregate. The fundamental issue faced by agricultural and financial policy makers is wehther or not the markets and institutions that serve agriculture have the capacity to accommodate these changes.

Using financial survey data in conjunction with a farm financial simulation model we are able to estimate the extent to which the agricultural society will restructure. These techniques are described more completely in Jolly and Doye (1985). Table 8 summarizes several dimensions of this restructuring process at true farm income levels.

Generally the income level can be related to the type and amount of commodity program support farmers receive. Average income corresponds to farm income continuing at 1984 levels. The low and high levels increase or decrease cash income of commercial farmers by $6 billion from the average level. This brackets the likely range in income levels, although lower seems more probable at the present moment than higher.

If current farm income levels are maintained, approximately $3.4 billion in interest would not be paid to creditors by financially stressed commercial farmers. The total debt service short-fall would be $8.0 billion. Farmers would liquidate approximately 21 percent of their assets as they attempt to reduce debts to serviceable levels. This compares to the normal 2 to 4 percent volume flowing through agricultural asset markets. Our estimates suggest 25 percent of commercial farms would fold before the sector achieves a stable financial structure. Debt losses by all creditors due to financial failures would be nearly 7 percent of commercial farm debt or approximately $11 billion.

Should income levels improve significantly, the restructuring levels would remain high - nearly 15 percent of commercial farm assets are liquidated and 15 percent of the operations quit farming. If farm incomes fall sharply below current levels, the estimated restructuring requirements become so large that the basic assumptions upon which the estimates are based become suspect. Further the prospect of 38 percent of commercial farmers failing with loans of over $20 billion to all creditors would be unacceptable to most policy makers.

NEEDED POLICY RESPONSE

Individual farmers adjust to financial stress by moving through a series of stages -- by increasing income through improved efficiency or cost-control,restructuring liabilities and finally by liquidating past or all of their assets. The agricultural sector has been moving through these stages at increasing speed since the current problem began in early 1980. Up to now, however, little significant change has occurred in stabilizing agriculture's financial structure. For the most part, the capacity of the agricultural sector to adjust has not yet bee tested.

Policy makers should consider developing programs to assist farmers with a particularly difficult period of transition. These programs may have several objections, among them:

1. To increase the liquidating of asset markets.
2. To share financial adjustment costs with farmers, lenders and the rest of society.
3. To reduce human suffering brought about by financial stress.

Assistance may take several forms:

1. Direct intervention with interest rate subsidies or, through the creation of land holding entities.
2. Removal of impediments to adjustment such as certain bank regulations or income tax provisions.
3. Financial, legal and personal counseling for farmers.

Financial assistance programs can ease the transition. They do not and cannot, by themselves, resolve agriculture's financial problems. Debt and asset restructuring along with improved efficiency remain the long-term solutions. Consquently, financial assistance programs should be evaluated on their ability to help farmers and lenders to adjust to changing economic conditions.

FINAL COMMENTS

In this paper we have attempted to look beyond current farm financial conditions and estimate the magnitude of change faced by the agricultural sector. It is, admittedly, a tentative and imperfect look into the future. However, our analysis does suggest that the adjustment may be very large and that it will likely push to the limit the ability of markets, individuals, institutions, and communities to make these changes. At the moment, the public response to financial adjustment in rural America has been draconian. It seems that rural Americans simply cannot pay enough for the excesses of the 1970's, despite the fact that the incentives to which they responded were created outside the agricultural sector. The current hands-off approach to financial policy, since it ignores the size of the problem and the capacity of the farm sector to adjust, may result in costs -- both in economic and human terms -- that easily exceed the cost of intervention.

Table 1. Incidence and Relative Frequency of Financially Stressed Farm Operations by Region

Region	Total 1/	Negative Cash Flow 3/		D/A Ratio Over 40 Percent		Insolvent	
Northeast	7.2	4.5 1/	62.8 2/	1.0 1/	14.2 2/	0.2 1/	3.0 2/
Lake States	12.7	6.0	47.3	3.3	25.6	0.4	3.3
Corn Belt	21.3	9.9	46.4	5.3	24.7	0.8	3.9
Northern Plains	10.7	5.3	49.1	2.9	26.7	0.4	4.0
Appalachia	13.7	6.6	48.0	1.3	9.5	0.1	0.9
Southeast	6.0	2.9	48.3	0.8	13.2	0.2	3.0
Delta	5.4	3.5	64.4	1.0	17.7	0.2	4.1
Southern Plains	12.0	6.1	51.2	1.3	11.2	0.3	2.1
Mountain	5.4	2.9	53.4	1.2	22.0	0.1	2.4
Pacific	5.7	2.7	47.5	1.0	16.6	0.2	3.2
United States	100.0	50.3		19.0		3.0	

1/ Percent of U.S. farms.

2/ Percent of farms in region.

3/ Net cash income from farming plus off-farm income less estimated family living expenditures and principal payment.

Source: 1984 Farm Costs and Returns Survey, USDA.

Table 2. Incidence and Relative Frequency of Financially Stressed Farm Operations by Sales Class

Annual Sales ($1000)	Total 1/ Farms	Negative 3/ Cash Flow		D/A Ratio Over 40%		Insolvent	
500 +	1.8[1]	0.7[1]	38.9[2]	0.7[1]	38.9[2]	0.1[1]	6.0[2]
250-499	4.1	1.5	36.6	1.6	39.0	0.2	5.8
100-249	13.6	5.4	39.7	4.5	33.1	0.6	4.7
40-99	18.1	8.6	47.5	5.0	27.6	0.8	4.4
10-39	23.3	13.4	57.5	3.8	16.3	0.8	3.4
Less than 10	39.2	20.6	52.6	3.4	8.7	0.4	1.0
United States	100.0	50.3		19.0		3.0	

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[1] Percent of U.S. farms.

[2] Percent of farms in region.

[3] Net cash income from farming plus off-farm income less estimated family living expenditures and principal payment.

Source: 1984 Farm Costs and Returns Survey, USDA.

Table 3. Percentage Distribution of Farm Operators, Their Debts and Assets by Equity Growth Rate and Region

	Equity Growth Rate (percent)				
Region	Insolvent or Less -20	-20 to -5	-5 to +5	+5 to +20	Over +20
Northeast					
Operators	16.5	23.9	31.2	17.6	11.0
Debt	26.8	16.7	21.7	19.9	14.7
Assets	7.4	19.9	43.2	10.0	9.5
Lake State					
Operators	12.7	15.9	28.7	28.1	14.8
Debt	23.1	12.6	23.5	30.6	10.0
Assets	8.5	12.4	33.4	37.3	8.3
Corn Belt					
Operators	14.2	15.3	26.0	25.2	19.2
Debt	28.1	11.4	20.0	20.5	20.0
Assets	9.9	12.4	33.8	30.2	13.9
Northern Plains					
Operators	17.5	13.7	28.9	25.8	13.9
Debt	24.2	17.7	23.6	21.1	13.4
Assets	9.7	13.4	37.9	30.8	8.3
Appalachia					
Operators	14.4	18.8	26.6	23.9	16.3
Debt	16.9	11.1	22.9	25.6	23.5
Assets	5.7	13.8	40.1	27.4	13.1
Southeast					
Operators	15.9	19.9	24.9	23.4	15.7
Debt	37.6	15.9	15.7	16.1	14.5
Assets	9.5	15.1	43.1	20.1	12.5
Delta					
Operators	19.0	24.6	27.1	15.1	14.2
Debt	32.6	18.6	25.1	9.5	14.2
Assets	9.1	18.3	33.5	15.2	8.1
Southern Plains					
Operators	17.4	19.0	27.3	21.1	15.1
Debt	35.1	19.5	17.8	15.5	12.2
Assets	9.1	16.9	47.0	18.8	8.3
Mountain					
Operators	14.0	13.6	39.1	20.5	12.7
Debt	24.6	15.2	29.6	18.6	11.8
Assets	8.2	11.8	53.4	20.4	6.3
Pacific					
Operators	10.7	17.2	31.0	27.1	14.2
Debt	35.1	11.5	20.8	20.4	12.2
Assets	8.4	12.9	44.5	25.2	8.8
United States					
Operators	15.1	17.5	28.3	23.6	15.5
Debt	27.6	14.3	22.2	21.2	14.7
Assets	8.8	14.3	40.8	26.2	10.0

Source: 1984 Farm Costs and Returns Survey, USDA.

Table 4. Percentage Distribution of Farm Operators, Their Debts and Assets by Equity Growth Rate and Sales Class

Sales Size Class ($1000)	Equity Growth Rate (percent)				
	Insolvent or Less -20	-20 to -5	-5 to +5	+5 to +20	Over +20
500 +					
Operators	16.1	8.9	18.9	23.3	32.8
Debt	32.6	7.5	18.2	21.2	20.4
Assets	13.1	12.8	28.7	27.4	17.9
250-499					
Operators	13.7	6.5	17.8	27.0	23.5
Debt	22.4	9.9	23.2	26.6	17.9
Assets	9.5	8.1	35.9	32.7	13.7
100-249					
Operators	13.0	10.2	23.0	33.3	20.5
Debt	22.8	15.5	22.6	25.5	13.6
Assets	7.8	11.3	37.8	32.8	10.3
40-99					
Operators	15.3	14.0	32.2	25.5	12.9
Debt	31.5	20.0	25.3	14.5	8.7
Assets	9.5	15.0	47.5	22.6	5.4
Less than 40					
Operators	15.4	21.0	29.0	20.5	13.9
Debt	31.9	17.0	20.8	15.6	14.6
Assets	7.3	20.0	45.1	20.5	8.2
United States					
Operators	15.1	17.5	28.3	23.6	15.5
Debt	27.6	14.3	22.2	21.2	14.7
Assets	8.8	14.3	40.8	26.2	10.0

Source: 1984 Farm Costs and Returns Survey, USDA.

Table 5. Average 1985 Financial Condition of Sample Iowa Farm Operators By 1985 Debt-to-Asset Ratio

	Debt-to-Asset Ratio (%)					
Financial Characteristics	0-10	10-40	40-70	70-100	100+	All
Assets ($1000)						
Non-Real Estate	136	166	236	156	85	166
Real Estate	282	375	420	348	152	340
Total	418	541	656	504	237	506
Debts ($1000)						
Non-Real Estate	6	44	121	143	190	60
Real Estate	4	82	238	251	124	101
Total	10	126	359	394	314	161
Net Worth ($1000)	408	415	297	110	-77	345
Debt-to-Asset Ratio (%)	2.4	23.3	54.7	78.2	132.5	31.8
Operator Characteristics						
Age	59	54	48	46	45	54
Years in Farming	35	29	25	23	22	29
Dependents	2.4	3.1	3.5	3.7	3.3	3.0
Dependents <18 Years	0.3	0.8	1.1	1.4	1.2	0.7
Husband Education[1/]	2.2	2.3	2.4	2.3	2.4	2.3
Wife Education[1/]	2.4	2.4	2.5	2.4	2.4	2.4
Acres Owned	235	280	295	271	159	261
Acres Rented	114	172	285	302	326	193
Acres Operated	327	430	562	539	484	433
Off-Farm Income	$7738	$5795	$6621	$5574	$9426	$6779
Percentage Distribution						
% Operators	35	32	21	7	4	100
% Assets	29	34	28	7	2	100
% Debts	2	25	48	17	8	100

[1/] Educational attainment, highest level attended
1 = grade school, 2 = high school, 3 = college or vocational

Source: 1985 Iowa Farm Finance Survey.

Table 6. Percentage Change in Financial Condition, 1984-1985
Iowa Farm Operators

	1984 Debt-to-Asset Ratio			
	Average	40-70	70-100	100+
Assets				
Non-Real Estate	- 8.8	- 6.9	-16.5	1.4
Real Estate	-21.5	-20.6	-31.4	-32.4
Total	-17.7	-16.1	-26.2	-21.2
Debts				
Non-Real Estate	13.2	7.0	- 2.4	11.8
Real Estate	- 1.9	- 1.6	-16.9	-32.7
Total	3.2	1.3	-10.4	- 6.9
Net Worth	-24.8	-34.5	-88.4	-62.2

Source: 1985 Iowa Farm Finance Survey.

Table 7. Average Percent Asset and Debt Liquidation
Required to Service Remaining Debt
Iowa Farm Operators

	Debt-to-Asset Ratio					
	40-70			70-100		
Income Level[1/]	Low	Current	High	Low	Current	High
Net Cash [illegible] ($1000)	-20.0	-11.4	-2.9	-37.4	-30.5	-23.7
Restructuring Option (Percentage Change)						
Scaleback						
Asset	43.0	28.6	8.7	NF	NF	NF
Debt	66.6	44.3	13.5	NF	NF	NF
Sale-Leaseback						
Asset	35.5	21.5	5.8	86.3	74.8	61.8
Debt	55.0	33.3	9.0	94.1	81.5	67.4
Debt Discharge						
Debt	35.6	20.3	5.2	59.3	48.4	37.6

Source: Jolly and Doye, FAPRI Staff Report #8.

[1/] Current income - 7.5 percent cash return on assets; low income - 6.5 percent cash return on assets; high income - 8.5 percent cash return on assets. The recovery rate on liquidated assets is assumed to be 85 percent.

TABLE 8

RESTRUCTURING REQUIREMENTS OF COMMERICAL FARMERS

	Income Level		
	Low	Average	High
Interest Shortfall ($ billion)	4.5	3.4	2.5
Debt Service Shortfall ($ billion)	9.8	8.0	6.5
Assets Sold (%)	30	21	15
Operations Selling Out (%)	38	25	18
Debt Written Off ($ billion)	20.7	11.0	6.2

Source: GAO Report

TESTIMONY BY

MAUREEN S. STEINBRUNER
EXECUTIVE VICE PRESIDENT
CENTER FOR NATIONAL POLICY

On behalf of the Center for National Policy's chairman, Edmund S. Muskie, and the members of our Board of Directors, I would like to thank the Chairman and Members of this Subcommittee for the opportunity to appear today.

The Center for National Policy is a public policy organization based here in Washington. Our purpose is to develop constructive approaches to national problems, and to foster better ways of achieving national goals.

For the past year, as part of a longer term project on food and agriculture policy, the Center has been among the many groups examining the farm credit problem, and addressing the question of whether there might be a reasonable way for the federal government to assist farmer-borrowers through the present debt crisis.

We recognize fully that reducing the federal deficit is a primary objective at this time. Lowering the deficit should, in principle, benefit the farm sector as well as other sectors of the American economy.

With this in mind, we have tried to identify that segment of all commercial farms having problems with debt specifically, so that any resources committed to debt relief would be used effectively. As you know, research conducted by a number of analysts, including Emmanuel Melichar, Neil Harl, Bob Jolly, their academic colleagues, and others at U.S.D.A. and in lending institutions, has helped to narrow the focus significantly by sorting out different degrees of indebtedness, or debt-to-asset ratios. More recently, using new data from USDA's Spring 1985 Farm Costs and Returns survey, the focus has expanded to include the issue of debt service capacity.

After consulting with a number of these specialists, we decided that it would be useful for our purposes to carry this line of analysis one step further.

Thanks to recent re-working of the data by USDA, this further step was possible, and we are now able to estimate with some degree of confidence that about 128,000 commercial farms are in a category which we believe should be considered the primary target group for any debt assistance program. About 66,000 other farms are close enough to being in this category that they could well be included. That would be a total of about 194,000 farms, and this is the number on which we have concentrated.

Let me explain briefly how we arrived at this number in sorting out the question of overall profitability from the specific problem of debt.

We first divided farm operations into three size categories. Based on gross sales in 1984, we counted as "large" farms with over $250,000 in gross sales. We counted as "medium" farms with between $40,000 and $250,000 in gross sales, and classified as "non-commercial" farms with sales of less than $40,000.

Second, for the purposes of this study, we looked at what we call farm "operating margins," -- essentially, a ratio of net to gross income, intended to reflect the relative degree of profitability of farm operations.

We constructed two different operating margins and compared them. The first margin was arrived at by accounting for direct cash operating expenses except debt service. The second was arrived at by accounting for operating expenses including debt service.

For the large and medium farms, we then sorted farms by operating margins, dividing them into the categories of negative margin (or net loss), medium margin and high margin. I should note that our analysis suggests that there are a number of farms that are operating with extremely favorable margins even under current circumstances, and even after debt service.

But about 15.5 percent of the large farms, and 16.4 percent of the medium farms report income and expenses which result in a calculation of negative margins before debt service is even considered. That is a little more than 103,000 farms by these estimates.

After debt service, the proportions with negative margins roughly double -- to 35.2 percent of large farms, and 36.7 percent of medium farms. This is approximately 128,000 farms in apparently serious trouble as a result of debt service.

How do these data relateto the information available on debt-to-asset ratios? If we look at the medium farms, we see that the average debt-to-asset ratio for all farms in our ? – medium category is 0.24 percent. That increases to an average of 0.36 percent for just those farms with negative margins.

As these data confirm, most farms have relatively small debts, although the averages are high by historic standards.

Also, we find that a not-insignificant segment of the farm sector is only marginally profitable now, or is not profitable at all, without regard to debt service costs, and in some cases at relatively low debt levels.

We believe that these circumstances complicate the credit problem immensely. Programs to deal with credit will not eliminate underlying problems of profitability. And, any program not carefully targeted will benefit many farm operations that are not in need of such assistance for survival.

Obviously, both the sector's income problems and its financial problems are centered in the current depressed condition of the market. What is the likelihood that this condition will change significantly over the next year or two? As you know, most analysts do not believe that aggregate income to the sector will improve significantly over this period. It is generally felt that there probably will be some relief on the expense side, due to declines in interest rates and energy prices. But overall supply and demand conditions are not expected to generate much improvement in farm income, if any, in the near term. And the degree to which interest relief can be granted to those borrowers most in need of it is not clear, given the lenders' need to build loan loss reserves.

Therefore, the pressure on borrowers, lenders and real estate values seems very likely to continue, particularly in certain regions of the country.

As we note in our study, there is always an argument to be made in cases like this that the government should take no particular action, and that adjustment should be allowed to occur unimpeded.

We do believe that there are a number of reasons why some action should be taken to relieve the debt stress on the system, but even if these reasons are not persuasive in current circumstances, it is possible that the stress will get worse before it gets better. Others who are testifying today are speaking to this point directly, and I will not attempt to offer a prediction. But I would like to suggest that if the situation does deteriorate much further, problems could be harder to contain, and there is some risk that options now available will be foreclosed.

In our study we have looked at the range of measures which different individuals and organizations have proposed over the course of the past year, and have tried to assess the costs and feasibility of such measures, using the target group that we have identified.

Direct intervention in land markets, to shore up real estate prices, would go at two parts of the problem at once -- land values and debt -- and is attractive from this perspective. But the costs involved in purchasing real property assets become very large very fast. If participation in such a program is strictly limited as a means of controlling costs, the ability of the program to have a real impact comes into question.

More assistance to lenders than is already being extended through FmHA programs, regulatory relief, and the recent Farm Credit system legislation, runs into the same trade-off: to the extent that participation is constrained for cost reasons, the need to address the problems on a broad basis, in order to stabilize the situation, is not met. A further difficulty with a lender-targeted strategy is that it does not necessarily have the intended effect on those borrowers who might best benefit from assistance.

A number of ideas introduced into the debate over this issue since the beginning of this year have begun to address this last question, with focus on the borrowers.

In our study, we concluded, as others have, that an assistance program combining a number of the elements suggested in such proposals might in fact be effective.

We examined the range of debt service relief that might be obtained through interest decreases, through stretchout of amortization periods, and through writedown of principal.

We made an effort in this examination to look at some realistic individual debt service examples, in order to relate the degree of relief which might be provided to the amount of relief which would be effective. This is difficult to do, and requires that a number of assumptions be made about real farm operations, their cash flow situation, and the range of debt burden which they might be carrying. But we believe that this analysis, in spite of its limitations, does contribute to a realistic picture of the possibilities for assistance in this situation.

Having done this, we decided that in fact some amount of government aid could make a significant contribution to the viability of debt restructuring efforts.

We have a specific proposal for such assistance, which we believe could be designed to limit the government's costs to a minimum in relation to the alternatives, at least the effective alternatives. It would involve lender costs, and it would require borrowers to put some equity on the line. Not all borrowers would be able to take advantage of such a program -- not even all in our target group -- and we assume that not all lenders would be both willing and able to participate to the extent needed for maximum coverage. But the proposal has the advantage of being designed so that the trade-off between participation and cost is minimized.

We are in the process of refining our cost estimates right now, and will have them available on Friday. We offer this proposal for discussion, and it may well be that it could be useful in relation to other proposals now under consideration by this Subcommittee.

I would be glad to try to answer any questions. We will submit a longer and more detailed summary of our analysis and proposal for the record.

Thank you very much.

TESTIMONY OF CONGRESSMAN BYRON L. DORGAN

NORTH DAKOTA

COMMITTEE ON AGRICULTURE

SUBCOMMITTEE ON CONSERVATION, CREDIT, AND RURAL DEVELOPMENT

APRIL 9, 1986

Mr. Chairman, I appreciate the opportunity to come before this House Agriculture Subcommittee on Conservation, Credit, and Rural Development to discuss the farm credit crisis facing American agriculture.

As I traveled throughout my state of North Dakota conducting town meetings and listening to what the people had to say, I viewed the deterioration of the family farm system with alarm and pain. The hopes and dreams of too many hard-working family farmers are in immediate danger!

The financial conditions of many farmers have been exhausted at a record pace from 1980 to date. The most significant factors affecting the financial status of farmers and their ability to continue operating appear to be:

- the impact of the decline in farm equity, or net worth, is reflected in falling farmland values and has reduced farmers' ability to secure operating credit;
- a basic change in lender policy in extending credit;

- falling commodity price trends combined with continuing increases in production costs, particularly in continued high interest rates incurred in borrowing;
- the cumulative adverse impact of successive years of weather-related problems on farmers in some parts of the country.

Obviously, the farmers most affected by these factors are those who in the immediate future will face difficulty obtaining short-term credit to continue operating.

And there is no question that credit is a problem. A number of farm organizations and observers in North Dakota -- the Dakota Resource Council, the Farmers Union, the Wheat Producers, independent bankers -- agree that farmers are having more difficulty getting loans to go into the fields this spring than they've had in many years. A few numbers help outline just how severe the problem is:

- The value of average quality farmland in North Dakota fell 13 percent in 1985, a drop unequalled since the Depression, when land values declined 12.5 percent between 1939 and 1940. Since peaking in 1981 at $454 per acre, average land values have fallen 26 percent in North Dakota. Cropland has fallen by 28 percent and pastureland by 33 percent since 1981.

- During 1985, some 200 farms in North Dakota accounting for 98,800 acres, were foreclosed. That means creditors foreclosed on North Dakota farms at a rate of nearly 17 a month. Yet, there were 25,628 acres foreclosed in the first two months of this year, which represent 25.9 percent (one-fourth) of all the acreage foreclosed last year.

- According to USDA economists, our nation's farmers had a debt-asset ratio of 23.65 percent as of Dec. 31. Simply put -- for every $100 in assets, American farmers owed an average of $23.65. The ratio has been at record levels since it rose to more than 20 percent in 1982 and for this year, USDA says the ratio could rise to another record of 24.9 percent.

- In a survey conducted in January by the Midwest Association of State Departments of Agriculture, it was revealed that when compared to eight other Midwestern states (Illinois, Kansas, Nebraska, Michigan, Ohio, Iowa, Missouri, and Wisconsin) North Dakota farmers were the most dependent on farming for their livelihood, with 73.2 percent of their income from farming. The average debt-asset ratio among North Dakota farmers was reported to be 34.7 percent, second to Iowa's 36.9 percent. North Dakota led the region in the percentage of farmers with debt-asset ratios above 70 percent, North Dakota having 14.7 percent in such condition.

- To further enhance the trauma farmers are facing, the Farmer's Home Administration is overwhelmed with loan applications as borrowers who no longer qualify for operating loans with commercial banks, PCAs or Land Banks turn to FmHA as the lender of last resort. The North Dakota FmHA has already lent more money for operating loans this year than it did for all of last year.

- Commercial banks are saying "NO" to lenders more often this spring, at the urging of the FDIC and state examiners, because, even if the collateral is there, bankers look at the market and don't see a profit margin.

According to the Federal Reserve Board, the greatest proportion of farm debt is owed to the Farm Credit System, the Farmer's Home Administration and individuals. Approximately 25 percent of this total is provided by commercial banks, and those banks which have large concentrations of such loans have been experiencing increasing strains in recent years. I'm aware that loan losses and the need to add to loan loss reserves because of the increasing volume of poor performing and/or nonperforming loans have decreased the earnings of many farm banks. The end result has been that an increasing number of farm banks have failed and the number of seriously troubled banks has risen considerably.

So, Mr. Chairman, in lieu of the forementioned financial obstacles which face most farmers and agricultural lending institutions in our nation, I strongly urge this Subcommittee to closely review, among others, bills H.R.3868 and H.R.4267.

In reference to H.R.3868, the Farm Credit Partnership Act of 1985, I believe that this proposal is a reasonable, fair approach to the current credit crisis. I agree with both Mr. Panetta and Mr. Stangeland that it is not a bailout, but rather it gives farmers and lenders an opportunity to jointly walk out of a problem they walked into together. It would help ease the adjustment process that is underway and help prevent the collapse of asset values that would occur in the event of mass foreclosures.

However, there are a few sections within the bill to which I have specific concerns.

First, both sections 301 and 302 contain language which prevents Farm Credit System loans from qualifying for the principal reduction provisions. Because the beneficiaries of this reduction are primarily the borrowers, this exception is inequitable. It directly penalizes borrowers from other commercial banks. I recommend that this restriction be eliminated.

Second, the provision which allows family farm corporations to qualify for up to $600,000 aggregate loan participation overlooks the fact that many farm corporations are wholly owned by an owner-operator or the operator and his spouse. In those instances, the same unit organized as a corporation would be eligible for greater assistance than if it were operated as a proprietorship. One possible remedy would involve specifying a maximum percentage of the ownership that could be held by one shareholder in order for a corporation to qualify for the higher limit. In addition, I believe unincorporated farmers should have access to the same credit as corporated farmers.

In reference to H.R.4267 (Titles II and III), a bill which I co-sponsored, would require the utilization of the FmHA's guaranteed operating loan program to encourage commercial lenders to restructure outstanding agricultural debt. A mandated 90% FmHA loan guarantee would be available to commercial lenders for the purpose of restructing existing agricultural loans. Lenders would be required to "write-off" a minimal portion of the borrower's outstanding debt and accrued interest. The guarantee would be in effect during the duration of the interest reduction program and would apply to the remaining principal after loan restructuring by the lender.

Through the interest rate buydown provision in the 1985 Farm Bill, the FmHA would participate in the reduction of the interest rate for the restructured loan package through a 1% buydown for each 10% reduction in principal by the lender.

In order to qualify for the FmHA loan guarantee, the interest rate on the restructured loan must be established at the cost of money to the lender. Notwithstanding the provisions of the interest rate buydown program, the lender would be required to absorb this interest rate reduction for a period of three years.

Mr. Chairman, while our government shouldn't have the responsibility to bail out every farmer who over-extended himself, it seems to me that farmers did no less than they were urged and expected to do in the seventies: produce food for export, maintain a livelihood, tough it out, and literally save whole communities from extinction.

We must be aware of the social disruptions and larger economic costs to our society if the federal government does not address the current credit crisis in farm country. This is not simply a problem that is revealed in farm debt and bank ledger numbers. It is a problem that shows up in increased alcohol abuse and family stress; in rural communities slowly dying as their main street businesses close one by one.

In the short term, we must ensure that adequate credit is available to worthy farm borrowers for spring planting. In the long term, I'm convinced we must seek an integrated fiscal and monetary policy that reduces the forces that have been so devastating to today's agriculture. This Administration must accept the blame for much of agriculture's current dilemma, and thus help restore this farm credit situation to sound financial footing.

TESTIMONY OF CONGRESSMAN JIM LIGHTFOOT

MR. CHAIRMAN, MEMBERS OF THE SUBCOMMITTEE, I APPRECIATE THE OPPORTUNITY TO APPEAR BEFORE YOU TODAY TO SHARE MY THOUGHTS ON THE SUBJECT OF FARM CREDIT ASSISTANCE LEGISLATION.

SINCE COMING TO CONGRESS LAST YEAR, I'VE SHARED YOUR PROFOUND CONCERN FOR THE ECONOMIC CONDITIONS IN RURAL AMERICA. IN THIS COMMON GOAL, WE SEEK TO IMPROVE THE FINANCIAL POSITION OF THE FARM COMMUNITY. THEREFORE, I WELCOME THE OPPORTUNITY TO LET YOU KNOW OF THE PROPOSAL I'VE INTRODUCED TO ASSIST IN RESOLVING THE FARM CREDIT CRISIS. IT IS MY HOPE THAT YOU WILL CONSIDER THIS PROPOSAL ALONG WITH OTHERS THAT YOU ARE REVIEWING FOR ACTION.

AS SOME OF YOU MAY KNOW, ON JANUARY 29TH, I INTRODUCED H.R. 4073, KNOWN AS THE "AGRICULTURAL INVESTMENT ACT". THIS LEGISLATION WAS DRAFTED WITH THE ADVISE OF RURAL AG BANKERS IN MY DISTRICT AND OFFERS A REALISTIC, LESS COSTLY ALTERNATIVE FOR PROVIDING LOWER COST LOANS FOR FARMERS.

THE MEASURE CREATES AGRICULTURAL SAVINGS CERTIFICATES SIMILAR TO THE "ALL SAVERS" PROPOSAL CONSIDERED A FEW YEARS BACK FOR THE SAVINGS AND LOAN INDUSTRY. H.R. 4073 PROVIDES THAT THESE U.S. SAVINGS CERTIFICATES CAN BE ISSUED BY MOST BANKS AND LENDING INSTITUTIONS AT VARIOUS RATES AND TERMS, WITH THE INTEREST EARNED ON THEM TAX-FREE. THE POOL OF MONEY CREATED BY THE PURCHASE OF THESE CERTIFICATES CAN BE LOANED, BY THE U.S. TREASURY AND SECRETARY OF AGRICULTURE, TO "AG BANKS" FOR MAKING LOWER INTEREST LOANS TO BONA FIDE FARMERS.

MY POINT IN THIS PROPOSAL IS TO LOWER INTEREST EXPENSES TO

FARMERS WHO OTHERWISE MIGHT NOT CASH-FLOW - ONE OF THE MOST DIFFICULT PROBLEMS CITED BY FARMERS - AT LESS COST TO THE GOVERNMENT THAN A DIRECT CREDIT SUBSIDY OUTLAY.

GRANTED, THERE WOULD BE SOME REVENUE LOSS BY NATURE OF THE INTEREST ON THE BONDS BEING TAX-EXEMPT. BUT THE COST TO THE TREASURY WOULD STILL BE MUCH LESS THAN A CREDIT SUBSIDY OUTLAY.

ALTHOUGH THE CONGRESSIONAL TAX COMMITTEES ARE RELUCTANT TO CONSIDER TAX-EXEMPT INSTRUMENTS SUCH AS THIS, THE TEMPORARY NATURE OF THE PROPOSAL AS WELL AS THE PUBLIC INTEREST BEING SERVED IN THIS AREA MORE THAN JUSTIFY THE USE OF SUCH A TOOL AT THIS TIME. MOREOVER, IT IS LIKELY THAT CONGRESS WILL PRESERVE THE USE OF SOME TYPES OF TAX-EXEMPT BONDS WHERE THEY ARE DEMONSTRATED TO BE IN THE PUBLIC INTEREST.

I'VE ATTACHED TO MY TESTIMONY A SHORT SUMMARY OF H.R. 4073 AND A FLOW CHART ON THE PROPOSAL'S OPERATION. I'D BE HAPPY TO ANSWER ANY QUESTIONS THAT MEMBERS OF THE COMMITTEE MIGHT HAVE REGARDING MY PROPOSAL.

THANK YOU.

(Attachments follow:)

SUMMARY OF H.R. 4073 INTRODUCED JANUARY 29, 1986 BY REP. LIGHTFOOT:

1. Banks may offer tax-free agricultural savings certificates yielding interest at any rate. ($10-$1000 increments with 10,15 or 20 yr. maturity.

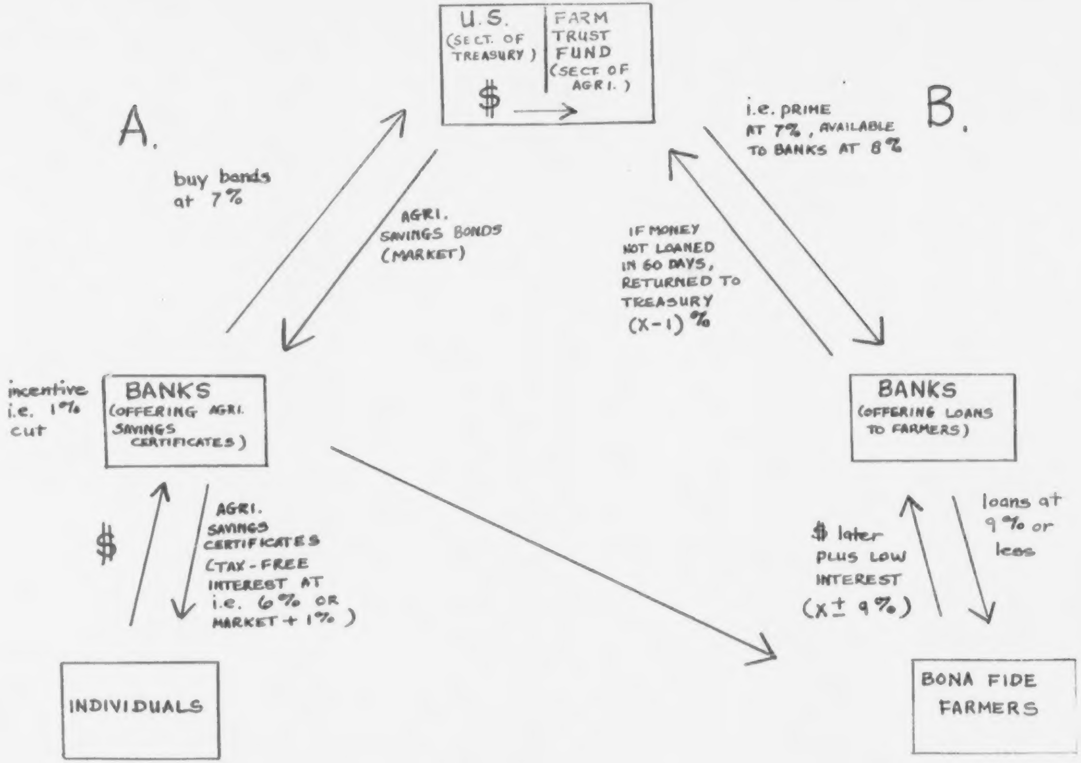
2. Banks (or any farm lender) must use proceeds from sale of certificates to purchase agricultural savings bonds yielding interest at a rate to be set by the Secretary of the Treasury.

3. U.S. issues agricultural savings bonds.

4. Proceeds from sale of such bonds are credited to the Farm Trust Fund.

5. The Secretary of Agriculture loans amounts in Farm Trust Fund, at interest rate determined by such Secretary after consultation with the Secretary of the Treasury, giving priority to lenders with the greatest proportion of the lender's funds already loaned to bona fide farmers (individuals with at least 50% of gross income from farming).

6. Lenders receiving such loans must lend such amounts to bona fide farmers at not more than 9% compounded annually, in amounts of no less than $40,000 and no greater than $500,000. To the extent such amounts are not loaned within 60 days, such amounts must be returned to the Secretary of Agriculture and loaned to other lenders.


U.S. (SECT. OF TREASURY)
FARM TRUST FUND (SECT. OF AGRI.)
$
A.
buy bonds at 7%
AGRI. SAVINGS BONDS (MARKET)
B.
i.e. PRIME AT 7%, AVAILABLE TO BANKS AT 8%
IF MONEY NOT LOANED IN 60 DAYS, RETURNED TO TREASURY (X-1)%
incentive i.e. 1% cut
BANKS (OFFERING AGRI. SAVINGS CERTIFICATES)
BANKS (OFFERING LOANS TO FARMERS)
$
AGRI. SAVINGS CERTIFICATES (TAX-FREE INTEREST AT i.e. 6% OR MARKET + 1%)
$ later PLUS LOW INTEREST (X ± 9%)
loans at 9% or less
INDIVIDUALS
BONA FIDE FARMERS

H.R.4073, "THE AGRICULTURAL INVESTMENT ACT" by REP. JIM LIGHTFOOT

STATEMENT OF

JOHN F. DOWNEY

CHIEF NATIONAL BANK EXAMINER

Before the

SUBCOMMITTEE ON CONSERVATION, CREDIT, AND RURAL DEVELOPMENT

COMMITTEE ON AGRICULTURE

UNITED STATES HOUSE OF REPRESENTATIVES

April 9, 1986

Mr. Chairman and members of the Subcommittee, I welcome this opportunity to appear before you to discuss the problems being experienced by agricultural banks. As you are well aware, the American agricultural economy continues to experience severe difficulties. Farm incomes and asset values, particularly the price of farmland, continue to decline, weakening the financial condition of highly leveraged farmers and putting pressure on agricultural lenders. The problems faced by agricultural banks will ultimately be eliminated only when the agricultural problem itself is eliminated -- a process that may take several years, depending among other things, on the future strength of export markets and the level of real interest rates.

This afternoon, I would like to provide the Subcommittee with some background information on agricultural banks and describe what actions our Office is taking to assist agricultural banks in making needed adjustments. I will then mention additional measures that could be taken by the Congress, the states, and the banks themselves to ensure that this adjustment is as smooth and painless as possible for both lenders and farm borrowers. Finally, I will comment upon relevant aspects of H.R. 3868 and H.R. 4267.

Profile of Agricultural Banks

Agricultural banks, defined by this Office as banks with over 25 percent of gross loans in agricultural credits, number 3,900 -- roughly a quarter of all U.S. commercial banks. These banks hold about half of the $47 billion in commercial bank credit to the farm sector, and their total assets constitute approximately 5 percent of the total $2.6 trillion in commercial bank assets. They are located mostly in the midwestern states. The median agricultural bank is only one-half the size of the median nonagricultural bank.

Until recently, agricultural banks generally out-performed comparably-sized nonagricultural banks. Due to their heavy concentration in farm loans and the growing credit quality problems in that sector, however, the condition of many agricultural banks has deteriorated in recent years.

As of December 1985, there were 810 national agricultural banks. Last year, 178 of these banks reported losses, compared with 134 at year-end 1984 and 78 at year-end 1983. The median ratio of classified assets to gross capital funds at all national agricultural banks reached 52 percent as of September 1985 (the most recent date for which these data are available), up from 39 percent one year earlier and 30 percent two years earlier. In contrast, the median ratio for nonagricultural banks rose only slightly over the past two years from 19 percent in September 1983 to 24 percent in September 1985.

The deteriorating condition of many national agricultural banks is also shown by their increased presence among the ranks of problem and failed banks. As of year-end 1982, only one percent of national agricultural banks were problem banks (i.e., had CAMEL[1] ratings of 4 or 5). However, as of

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[1] The CAMEL rating is a summary of the condition, on a scale of 1 to 5, of a bank at the time of examination. It is based on assessments of capital, assets, management, earnings and liquidity.

December 1985, 13 percent of all national agricultural banks, or 103, were problem institutions. Of the 30 national banks that failed in 1985, 10 were agricultural banks. Five of the 8 national banks that failed in the first quarter of this year were agricultural banks.

Despite the serious problems facing many agricultural banks, we believe that a majority have sound prospects for the future. Even with large losses and the likelihood that these losses will continue in the coming months, agricultural banks remain basically strong. Many of these banks possess capable management who have adapted and adhered to sound lending policies.

As a result, most agricultural banks hold significant amounts of capital and are continuing to generate earnings that equal or exceed those of other comparably-sized commercial banks. As of December 1985, 93 percent of national agricultural banks reported capital in excess of 7 percent of assets; 57 percent had capital in excess of 9 percent. While 22 percent of national agricultural banks reported year-end losses, almost 35 percent of all national agricultural banks reported a return on assets (ROA) of 1 percent or greater.

Our intention in providing these statistics is not to suggest that there is no problem. For the banks that fail, the consequences are traumatic -- for their employees, their shareholders, and the communities they serve. We are optimistic, however, that the bulk of the agricultural banking sector possesses the resources, management talent, and willingness to work with their borrowers to achieve mutually satisfactory solutions.

The OCC's Actions

It is our view that the most beneficial thing we can do is to ensure that banks have the opportunity and incentive to work with their borrowers to achieve mutually satisfactory loan work-out plans. It is only by identifying their losses and restructuring credits to reduce farmers' debt burdens that agricultural banks will be able to put their problems behind them and improve the quality of their portfolios.

Although such restructuring would be in the long-run best interest of banks and their borrowers, many banks have been reluctant to write down loans or to grant other concessions to borrowers because this might reduce their capital levels. Banks fear that reduced capital levels are unacceptable to the bank regulators. In addition, they are reluctant to reduce capital because it is the basis for determining the amount that a bank can loan to any one borrower. Lower capital levels would result in lower lending limits.

In response to these concerns, this Office, in conjunction with the Federal Reserve Board and the Federal Deposit Insurance Corporation, recently decided to institute supervisory policies that would give banks the tools and the encouragement to effectuate long-term restructuring of problem credits during this difficult but transitional period. The agencies released a Joint Policy Statement on March 11, 1986, broadly outlining these policies. A copy of that statement is attached.

This Office subsequently issued Banking Circular 212 which explains how the Comptroller of the Currency is implementing the Joint Policy Statement. The Circular became effective on March 28, 1986, and will terminate on January 1, 1993. The Circular covers five essential points:

- First, we reiterated our previous encouragement that banks enter into work-out plans with their agricultural borrowers who are experiencing temporary difficulties. Lenders may often find that their most prudent policy is to restructure loan terms rather than take more precipitous action such as foreclosure.

- Second, we again provided banks with a summary and examples of the June 1977 rule regarding the proper accounting of restructured debts. Under the Statement of Financial Accounting Standards No. 15, a bank need not recognize any loss on a restructured loan when the expected payments, principal and interest combined, equal or exceed the loan amount on the bank's books prior to the restructuring.

- Third, we are modifying the reporting requirements for restructured loans. Previously, restructured loans paid in accordance with the modified terms were reported on a schedule with problem loans. This schedule was available to the public. We are amending the schedule so that only restructured loans not being paid in accordance with the modified terms are categorized with other problem loans.

- Fourth, we instituted a capital forbearance policy. Under this policy, well-managed banks whose capital falls below historical levels, as a result of problems in the agricultural sector, will be given up to 7 years to restore capital. This policy is designed to help national banks that have sufficient capital to absorb loan losses and replenish capital. Capital forbearance formally acknowledges that capital should be used during periods of unusually heavy loan losses and that capital replenishment takes time.

- Fifth, we are amending the rules limiting the size of loans a bank can make to a single borrower. National banks were able to lend to any individual an amount no greater than 15% of the bank's capital under a general lending limit. For banks suffering agricultural losses, we are increasing the lending limit to a maximum of 20%. Thus, a bank whose capital declines as much as 25% due to farm loan losses will still be able to keep its old lending limit in order to meet the credit needs of its customers.

A copy of our Banking Circular is also attached to this statement for your information.

We believe these policies will help basically sound, well-managed banks through a difficult but transitional period. These policies should prove beneficial not only to agricultural banks, but to farmers and other customers as well. And finally, the policies have preserved the integrity of bank financial statements, which is vital to assuring confidence in the banking system.

The Need For Federal and State Actions

Although we believe that our capital forbearance and related policies will help agricultural banks to deal with their current problems, these policies are not a panacea. They do nothing to mitigate the underlying causes of problems faced by agricultural banks, i.e., the downturn in the agricultural economy.

In our view, the most important thing agricultural banks can do to improve their ability to withstand future downturns in the farm sector is to diversify their assets. A high concentration of loans to, or dependence upon, a particular industry is generally an imprudent lending strategy because it makes banks extremely vulnerable to that industry's performance. Diversification is currently hindered, however, by restrictions on geographic expansion and on loan sales and purchases.

We have encouraged states with restrictive intra-state branching laws to consider changing these laws to open new opportunities to agricultural banks for lending. We have also encouraged Congress to consider extending and amending the emergency acquisition provisions of the Garn-St Germain Act of 1982 by allowing emergency acquisitons of a failing bank before it has been declared insolvent, by reducing the asset size of an eligible failing bank and by allowing the acquisition of the entire holding company of a failing bank rather than just the bank. Such liberalizations would increase the options available to bank regulators to prevent and resolve bank failures. These actions would also help ensure the continued availability of banking services to farm communities.

States should also be encouraged to remove prohibitions on farm ownership that limit the market for farmland. The OCC has responded to this problem by generally allowing national banks to hold farmland acquired through foreclosures for as long as ten years, the maximum allowed by law. As a result, these banks are not forced to put real estate on the market at an inopportune time, which could further depress farmland prices.

Diversification of assets is particularly difficult for those banks in states where agriculture and related industries dominate the economy. The larger regional and multinational banks can originate loans nationwide and thereby lend to a variety of industries, but it is virtually impossible for smaller banks to achieve the same levels of diversification.

Although the sale of loan pool participations is one way for banks to diversify their loan portfolios, there are some obstacles that particularly impact the smaller community banks. Glass-Steagall prohibitions against commercial bank underwriting of securities mean that loan pool participations must be carefully structured. They tend to be available only in relatively large denominations -- usually $1 million or larger. Also, they can have only a limited number of potential acquirers. Finally, acquiring banks are required to receive and analyze extensive documentation associated with each participation. Collectively, these features of loan pool participations limit their usefulness for smaller banks.

- Specific authorization by Congress for commercial bank underwriting of interests in pools of bank loans, either by private placement or by public offering, could significantly enhance the availability of loan sales for small banks and thereby assist in the diversification of portfolios.

Actions Needed by Agricultural Banks

While actions by the Congress, the states, and bank supervisors will certainly ease the transition agricultural banks need to undergo, their long-term survival requires that agricultural banks themselves take several actions.

We have issued guidelines requesting agricultural banks to review the effectiveness of their lending policies. Unfortunately, a number still lack adequate agricultural lending policies. In such cases, we stress that they should be established or revised to include:

- analyzing each borrower's cash flow and profitability from production before the loan is made;
- establishing and maintaining accurate and realistic appraisals on all collateral supporting agricultural loans;
- identifying repayment sources and establishing specific repayment terms for various categories of agricultural loans; and
- building a cushion in collateral values and anticipated cash flows to protect against a downturn in such values or cash flows.

Agricultural banks that ensure that accurate risk assessment and prudent collection policies and practices are in place will be less vulnerable to deteriorating loan quality, even during economic downturns.

Comments on Proposed Bills

You also requested our comments on two proposed bills, H.R. 3868 and Titles II and III of H.R. 4267. Although these bills may create additional and inappropriate costs to the Federal government, our specific comments will relate only to the effect these bills would have on national banks. We will defer to the Department of Agriculture on questions relating to the need for these proposed laws.

H.R. 3868:

H.R. 3868 would provide interest rate subsidies for qualified agricultural loans, Farmers Home Administration guarantees for restructured agricultural loans, and would create an interagency task force to assist commercial agricultural banks and their borrowers in working through the present economic problems. The task force would review existing policies and consider meaningful alternatives including, regulatory, statutory, and accounting changes, in order to facilitate commercial bank lending to agriculture in the future.

This Office favors voluntary programs that augment a farm lender's ability to grant concessions and thereby improve the ability of troubled borrowers to service their debts. Voluntary principal and interest rate buydown programs increase the likelihood that a satisfactory workout can be arranged. Accordingly, we have supported the existing Farmers Home Administration Debt Adjustment Program in which the government guarantees renegotiated loans on which a bank has written down the principal and/or reduced interest charges sufficiently for the borrower to service his debt.

H.R. 3868 contains some provisions that we believe deserve reconsideration, however. Section 203(a), for example, would limit the rate of interest on restructured loans, at the end of the interest rate buydown period, to the rate the bank would charge on loans with comparable maturities for similar purposes. This provision would prevent lenders from charging an interest rate that reflects the appropriate risks of repayment and may force lenders to restructure troubled loans around that rate to the detriment of borrowers. H.R. 3868 also appears to limit the repayment period to no less than the original maturity of the loan being restructured. This provision would preclude lenders from restructuring loans to have shorter maturities accompanied by significantly lower interest rates. The program is more likely to be effective if lenders and borrowers are free to negotiate a maturity that matches the circumstances, rather than being forced to match statutory limitations.

The bill also provides that guaranteed loans may not be transferred. We believe that this limitation may deter banks from entering the program because they would not be able to sell the loans to free-up funds to make additional loans. As mentioned earlier, we are hopeful that ways can be found to enable banks to more easily sell loans or loan pool participations so that they can both diversify and continue to meet the needs of local customers. The ban on transferability appears to run counter to these goals.

H.R. 3868 also contains requirements for program audits and monitoring of lenders by both states and the Department of Agriculture. Of particular concern to us is Section 203(f), which would grant the relevant state agency the authority to monitor compliance by lenders, including national banks. The result would be a duplication of effort by the state agency and the Comptroller's Office and an increased regulatory burden on the banks. Historically, Congress has preserved the exclusive jurisdiction of the Comptroller's Office over national banks regardless of the subject matter. Should H.R. 3868 move forward, we would hope that you will amend this section to eliminate the state monitoring authority with respect to national banks.

We strongly object to the proposed new Section 351(c)(6) of the Consolidated Farm and Rural Development Act, which requires the loss portion of a restructured loan to be amortized on a bank's financial statements over a 10-year period. If enacted, the provision would distort the true condition of banks, undermining public confidence in the integrity of the banking system as a whole. We believe the actions we have taken, granting capital forbearance and lending limit relief, provide the same benefits as loss deferral without creating this adverse side effect.

Finally, we do not believe, as proposed in Title IV of H.R. 3868, that it is necessary or desirable to establish by statute an interagency task force to assist agricultural lenders. The financial institution regulatory agencies are currently working together on the problems of institutions lending to the agricultural sector. In fact, the recent joint actions taken by the agencies already address those areas that H.R. 3868 proposes to be addressed by an interagency task force.

H.R. 4267:

Title II of H.R. 4267 would provide guarantees for restructured agricultural loans. As just indicated, we encourage the development of voluntary principal and interest rate buydown programs. However, Title II of H.R. 4267 contains a provision that we believe may limit its effectiveness. Under Section 201 of the bill, the Consolidated Farm and Rural Development Act would be amended to limit the interest rate on a restructured, guaranteed loan to the bank's current cost of funds. We believe that banks may not want to participate in the program if their ability to recover administrative expenses and overhead, and their ability to generate a positive rate of return, is impaired. As we understand the restructuring provisions and the subsidy arrangement, banks will have already taken a 9% loss in connection with obtaining the guarantee.

Title III of H.R. 4267 would permit the amortization of qualified agricultural loan losses and losses resulting from reappraised agricultural real estate or other property over an extended period of not more than 10 years. We are opposed to the loan loss amortization provisions embodied in this bill for the reasons previously discussed.

Conclusions

The current difficulties being experienced by agricultural banks reflect farmers' severe financial stress. It is unrealistic to expect that the agricultural sector will return to the prosperity enjoyed during the 1970s any time in the foreseeable future. Consequently, the agricultural economy, including banks operating in that economy, will have to adjust to a lower level of farm income and to reduced asset values more in line with prospective income.

We believe the regulatory policies contained in our recent actions will provide agricultural banks with incentives and the time needed to address asset quality in a thoughtful and orderly manner, meeting the needs of the borrowers they serve, and helping to rehabilitate both the borrowers and the bank. These policies will, I believe, also preserve principles important to bank regulation and supervision and to the maintenance of public confidence in banking institutions.

I am confident that agricultural bank problems can be resolved through the cooperative efforts of banks, their supervisors, state government and Congress. Although H.R. 3868 and H.R. 4267 are examples of possible actions intended to assist lenders and farm borrowers through the downturn in the agricultural economy, we would oppose them in their current form. We stand ready, however, to work with you in developing more appropriate legislative measures.

(Attachment is held in the committee files.)

Statement by

William Taylor, Director

Division of Banking Supervision and Regulation

Board of Governors of the Federal Reserve System

I am pleased to appear before this Committee today to review the problems being experienced by banks in our agricultural communities and to discuss various proposals to ease the strains resulting from these problems, including H.R. 3868 ("The Farm Credit Partnership Act") and H.R. 4267 ("Emergency Farm Income and Credit Act of 1986").

The agricultural sector of our economy is experiencing greater problems today than at any time since the Great Depression of the 1930's. Farm incomes and farm asset values have declined sharply over the current decade as crop prices -- responding to a major increase in the global supply of farm products relative to demand -- have dropped substantially. All of our farmers have been adversely affected by these developments but not all to the same degree. Farmers that are relatively debt-free generally have maintained strong financial positions although significantly less so than a few years back. In contrast, farmers who entered the 1980's substantially in debt have experienced an erosion in their financial health generally commensurate with their degree of leverage.

Our staff estimates suggest that about a third of the full-time producers on commercial-sized family farms are experiencing financial stress. This group owes about one-half of the farm debt of all such operators. The problems of these farmers have been compounded by the relatively high interest rates that have prevailed over the current decade. In addition, their efforts to restructure debt, or to reduce it by selling some of their assets, have been hampered greatly by the decline in farm asset values.

The great proportion of farm debt is owed to the Farm Credit System, the Farmers Home Administration and individuals. But about one-quarter of the total is provided by commercial banks, and the banks that have concentrations of such loans have been experiencing increasing stress in recent years. For example, past due and nonaccrual loans at agricultural banks[1] accounted for 7 1/4 percent of total loans at the end of last year, up from 6 1/4 percent a year earlier, and from around 5 percent at the end of 1982 (the first date for which such data are available). This increase has taken place even as these banks have made substantial charge-offs of their loans. Charge-offs have increased in each year of the decade, rising from just under 1/3 of one percent of total loans in 1980 to over 2 percent of total loans last year.

Given the high volume of loan losses and the need to add to loan loss reserves to cover potential losses inherent in the increasing volume of poor performing and nonperforming loans, the earnings of farm banks have declined steadily and substantially over the decade. The proportion of farm banks posting negative earnings rose to 18 percent last year, up from 1 percent at the turn of the decade. And another 30 percent of all farm banks reported earnings on equity of less than 10 percent last year; by contrast, only about 10 percent of the farm banks had earnings this low during the late 1970's and early 1980's. Altogether, agricultural banks recorded a net return of 6 percent on equity in 1985, down from 16 percent in 1980.

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[1] For purposes of this testimony agricultural banks have been defined as those with a ratio of farm loans to total loans that exceeds the average of such ratios for all banks, now about 16 percent.

One manifestation of these various negative trends has been a rising number of agricultural bank failures. Nearly 70 agricultural banks failed last year, more than double that recorded in 1984 and up from a minimal number in the late 1970's and early 1980's. Moreover, the number of farm banks with serious problems has continued to increase. One indication of this is that at the end of last year there were 330 agricultural banks that had poor quality loans that exceeded their total capital; just a few years back the number was less than 100. The further increase in this number reflects not only a rise in poor quality loans but also an erosion of capital that has occurred at many of these banks due to loan write-offs.

Having reviewed the negative side of the farm bank situation, I believe it important that I briefly relate the positive side to provide a balanced perspective. Nearly 93 percent of the total loans at all agricultural banks are generally of good quality. One-half of all farm banks reported earnings last year equal to at least 10 percent on their equity. Also, agricultural banks generally have a substantial capital cushion to absorb loan losses. The ratio of capital to assets at all agricultural banks averaged 9 3/4 percent in September of last year, higher than it was at the start of the decade and well above the 7 1/2 percent ratio for the entire banking system.

There are also a number of recent developments that should work to assist the farm economy, including the recent dramatic fall in energy prices and the substantial declines in interest rates and in the exchange value of the dollar. The recently enacted farm bill offers an additional source of support for farm incomes. At the same time, however, prospective supply conditions for farm products, both at home and internationally, suggest that a substantial rebound in crop prices, and thus in farm incomes, is not likely to take place in the near term. Certainly it would appear unwise to base public policy on the assumption such a rebound will take place. Accordingly, while farmers that are now financially healthy should be able to avoid serious problems and many borderline farm operators may be able to work out of their current difficulties, many other farmers with relatively heavy debt loads face a continuation of serious difficulties. That means, of course, that a sizable number of farm banks will also continue to experience severe strains.

Mr. Chairman, it is altogether understandable that the Congress is seeking to identify approaches by which appropriate assistance can be provided to troubled farm banks to aid them and their farmer customers to get through this period. In your letter requesting a Federal Reserve representative to appear here today you asked for comment on two such proposals, those set forth in H.R. 4267 and H.R. 3868. In my remaining time, I will summarize the Board's assessment of these proposals and then review with you the actions that the Federal Reserve, OCC and FDIC have recently taken to help alleviate the problems being faced by farm banks and their farmer customers.

Review of H.R. 4267 and H.R. 3868

The provisions of Titles II and III of H.R. 4267 would basically augment, with certain modifications, existing Farmers Home Administration (FmHA) loan programs. Lenders would be offered the opportunity to receive a FmHA guarantee on principal and accrued interest on restructured farm loans, provided that: (1) principal and accrued interest on the original loan are reduced by at least 10 percent; (2) the restructured loan is extended at an interest rate at or below the lender's cost of funds; and (3) the borrower is able to demonstrate a positive pro forma cash flow for at least five years following the restructuring. In addition, lenders would receive a 1 percent FmHA interest subsidy for each 10 percent of loan value written off.

H.R. 3868, "The Farm Credit Partnership Act" would offer a similar package of assistance. It, too, would provide an interest rate subsidy that is tied to the size of a principal write down and extend a government guarantee to the remaining loan balance. The interest rate subsidy in this proposal would appear to be a bit more generous, however, ranging up to 5 percentage points. It would be provided as follows: 2 percent by the Federal Government; 2 percent by a state government (if a state chooses to participate in the program); and 1 percent by the lender.

It appears that the proposed bills are intended to encourage a greater volume of farm loan restructurings by going beyond existing Farmers Home Administration programs. In addition to the encouragement that would be provided by the more generous interest subsidies offered by H.R. 3868, both proposals would authorize lenders to write-off loan losses over a 10-year period rather than in the year in which the losses occur, the present practice.

The debt restructuring programs proposed under the two bills would undoubtedly benefit farmers. Farmers that participate in these programs would be forgiven part of their debt obligations and have their interest costs reduced while retaining full title and use of their assets. Lenders would also receive clear benefits even though they would experience a loan writedown and might stand to receive less interest than was promised in the terms of original loans. But these are conditions that they would face in any event in the case of these loans so they are made no worse off by these features of the proposals. At the same time, they obtain a full government guarantee on restructured debt and, at least in certain cases, receive an interest subsidy that will provide them greater interest revenues than they would otherwise receive.

Unfortunately, these benefits to farmers and banks would not come free, as the costs of a large part of interest subsidy and of losses on loans guaranteed would be borne by the taxpayer. In addition to these budgetary considerations such an assistance program raises the question whether similar aid should be provided, now or in the future, for other broad classes of borrowers at U.S. banks and other lenders that are encountering difficulties.

In addition to the budgetary issues, we have serious reservations regarding the provisions of the bills that authorize banks to defer loan losses over a ten-year period. Such a deferral does not address a bank's fundamental financial problems. Consequently, in the case of a bank whose capital has been severely depleted or eliminated by loan losses and whose earnings prospects are poor, deferral of loss recognition, rather than providing a solution to a problem, simply puts off the day when such problems must be faced. And that raises the clear danger that when the problems are addressed they will be more difficult to sort out and resolve and will prove more costly to the deposit insurance fund. Thus, in such circumstances the Board believes it would be far better to seek a permanent solution to the bank's problem by having it obtain new capital or, if its problems are too severe, by merging it with a stronger institution.

There are, of course, less extreme situations in which a bank has suffered substantial loan losses but, even after recognition of these losses, retains a sizable amount of capital -- although perhaps not up to minimum supervisory standards -- and has reasonably good prospects for recovery over time. In these cases rather than allowing banks to amortize losses over a number of years and then report regulatory capital at an artificial level, it would be more straightforward for supervisors to permit them to operate with capital at reduced levels, even if below supervisory standards. The Federal Reserve and other bank supervisors have decided to employ this approach as part of their general program for assisting farm and energy banks.

Another undesirable feature of stretching out loan losses over a number of years is that this practice is not consistent with Generally Accepted Accounting Principles (GAAP). As a consequence, regulatory accounting statements would show levels of capital higher than that reported on financial statements prepared under GAAP. This disparity would tend to cause public confusion and impair the usefulness and credibility of regulatory financial statements.

In this regard the Board would note that generally accepted accounting principles already provide a reasonably flexible approach for restructuring troubled but viable loans. In particular, FASB 15 permits a lender to restructure troubled loans provided that under the modified terms the total of anticipated future cash receipts can reasonably be expected to at least equal the original principal of the loan. This, too, is an element of the assistance program the banking agencies have agreed to implement to assist farmers.

Banking Agency Policies to Assist Farm and Energy Banks and their Customers

Having offered the Board's general views on HR 3868 and HR 4267, I should now like to review that assistance program with you. The key elements of the program were first described on March 11, when the Federal Reserve, FDIC and OCC issued a joint policy statement in conjunction with their appearance before the Senate Committee on Banking, Housing and Urban Affairs. How these policies might be specifically implemented were discussed during the hearings, and further discussions were held with members of the Senate as well as other members of the Congress subsequent to the hearings. One important outcome of these discussions was that the program, which was focused on farm banks and their customers when the joint statement was issued, was extended to energy banks and their customers. At the end of March, the three agencies decided to formally implement the assistance program.

For its part, the Board had already instructed the Reserve Banks -- in a telephone conference call held just after the Senate Banking Committee hearings -- to generally conform their practices and procedures to the policies outlined in the joint statement. Written instructions for implementing the program were sent to the officers in charge of supervision and regulation at Federal Reserve Banks on March 28. Since I am attaching a copy of this letter which discusses the policies of the program in some detail, I will limit my remarks here to the following summary of its key elements.

Capital Flexibility. The Federal Reserve will exercise forbearance in applying its capital guidelines to situations in which banks have suffered an erosion of their capital base because of losses on farm and energy loans but have the clear potential for restoring their capital position over a reasonable period of time. This approach is basically consistent with the objective that was sought in establishing these guidelines -- namely to ensure that banks maintain adequate capital during reasonably good economic times so that they are able to withstand and ultimately overcome unanticipated loan losses or other adversities that can occur when times turn bad.

Bank Forbearance on Farm and Energy Loans -- The Federal Reserve has reaffirmed its policy of not discouraging banks from forbearing on farm loans in cases where there is a reasonable prospect that a loan restructuring will work to the benefit of the bank as well as the borrower. Recognizing the dislocations that may result from the decline in energy prices, the Federal Reserve believes it also appropriate to follow this policy in the case of energy related loans.

Utilization of FASB 15. Consistent with the loan forbearance policy, the Federal Reserve will not require an automatic charge-off of restructured loans when they meet the criteria set down in Generally Accepted Accounting Principles -- in particular, Financial Accounting Standard No. 15 (Accounting by Debtors and Creditors for Troubled Debt Restructurings).

Change in Reporting of Restructured Loans. To avoid possible public association of restructured loans that are performing in accordance with modified terms with past due and non-accrual loans, such restructured loans will henceforth be reported in the regular loan schedule of the Call Report.

Before concluding, I would point out that the assistance program will not, by itself, address all problem situations that appear likely to arise in the farm and energy sectors. It seems unavoidable that we will continue to have banks with problems so severe that they cannot continue to operate without an infusion of additional capital and fresh management. It is very important for banking supervisors to be able to deal with these situations as quickly and effectively as possible in order to minimize their impact on local communities and on the banking system generally.

To help achieve the disposition of serious problem situations in that way, the Federal Reserve would encourage the Congress to modifiy provisions of the Garn-St Germain Act of 1982 which prohibit acquisitions of failed banks across state lines before an actual failure occurs and which also prohibit acquisitions of failed banks with assets under $500 million. The Board believes that these two constraints should be eased by allowing across-state acquisitions of failing banks and by reducing the size of failed and failing banks that can be so acquired. In addition the Board also believes that the acquirer of such banks should be permitted to purchase the bank's holding company and its affiliates.

Mr. Chairman, that concludes my formal remarks.

(Attachment follows:)

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

DIVISION OF BANKING
SUPERVISION AND REGULATION

March 28, 1986

TO THE OFFICER IN CHARGE OF SUPERVISION
AT EACH FEDERAL RESERVE BANK

Subject: Supervisory Policies to Assist Banks
with Problem Agricultural and Energy Loans

The decade of the 1980's is proving to be particularly difficult for farmers and firms in the oil and gas industry and for the banks that serve them. Economic conditions have shifted sharply and unexpectedly in both of these important sectors of our economy, and farmers and energy-related firms have suffered substantial declines in income and asset value. As a result they have found it increasingly difficult and in some cases impossible to service their outstanding indebtedness. A major consequence of these developments is that banks with sizable portfolios of farm loans or energy loans or some combination of the two have come under growing strains, as reflected by a comparatively large number of bank failures and a mounting number of problem bank situations.

In recognition of the severity of the problems being faced by banks and their agricultural and energy related customers, the Federal Reserve, OCC and FDIC have agreed to employ a common set of general supervisory policies to assist basically sound, well-managed banks to weather this period of economic adversity. The agencies in recent testimony before the Senate Committee on Banking, Housing and Urban Affairs outlined these policies and on March 25 the Committee approved legislation for consideration by the full Senate that, among other things, would require the agencies to follow these policies.

The purpose of this letter is to provide you with a general summary of these policies so that you may immediately conform the general approach of your operating procedures and practices to them.

Capital Flexibility. As a result of losses in farm and energy loans, the capital positions of many banks have been reduced considerably and further erosion appears in prospect. Thus the capital ratios of many farm and energy banks have dropped, or have the prospect of dropping, well below normal levels and in cases of greater difficulty below minimum levels set out in regulatory standards.

In these situations, the Federal Reserve has emphasized that it intends to exercise appropriate forbearance in applying its capital guidelines. More specifically, banks experiencing such difficulties are to be allowed to operate with reduced capital levels, even if below the minimum standards set down in our guidelines, provided that they have the clear potential for replenishing their capital position over a reasonable period of time. This approach is basically consistent with the objective that underlies our existing capital guidelines -- namely, to insure that banks maintain adequate capital during reasonably good economic times so that they are able to withstand and ultimately overcome unanticipated loan losses or other adversities that can occur when times turn bad.

In carrying out this capital forbearance policy, state member banks should be instructed that, when loan losses have caused their capital ratios to fall to levels materially below the minimum standards of the capital guidelines, they should notify their Reserve Bank immediately. Following this notification, the banking organization should submit, in a short period of time, a report to the Reserve Bank spelling out in suitable detail a plan for restoring capital to normal levels. This plan should cover, in particular, the bank's intended policies regarding earnings retention, executive salaries and growth. Obviously, in these circumstances commercial banks will be expected to limit dividends, control growth and conserve expenses.

Bank Forbearance on Farm and Energy Loans. The Federal Reserve has reaffirmed its policy of not discouraging banks from forbearing on farm loans in cases where there is a reasonable prospect that the restructuring will work to the benefit of the bank as well as the borrower. Recognizing the dislocations that may result from the decline in energy prices, the Federal Reserve believes it also appropriate to follow this policy in the case of energy related loans. Consistent with this general approach, the Federal Reserve will not require an automatic charge-off of such restructured loans when they meet the criteria set down in Generally Accepted Accounting Principles, -- in particular, Financial Accounting Standard No. 15 (Accounting by Debtors and Creditors for Troubled Debt Restructurings). FASB #15 allows a financial institution to continue to show the principal value of a restructured credit on its books provided that the total of anticipated future cash receipts under the new modified terms can reasonably be expected to be received and are at least equal to the principal value of the loan.

Consistent with the supervisory actions set forth above, regulatory reporting procedures as they pertain to restructured debt are being revised. Under current call report instructions, restructured loans are reported in conjunction with past-due and nonaccrual loans and are designated as "renegotiated troubled debt." This presentation has caused restructured loans that are performing in accordance with the new terms to be construed by analysts and the public as a component of nonperforming assets. In order to address this situation, the regulatory reporting of restructured loans in the call report will be shown separately from the past-due and nonaccrual loans, and such restructured loans that are performing under the new terms will be designated as "loans restructured and in compliance with modified terms." Restructured loans that cease to perform in accordance with the new terms will be reported in the appropriate past-due or nonaccrual category as applicable.

William Taylor

WILLIAM TAYLOR
DIRECTOR

A. DAVID MEADOWS
ASSOCIATE DIRECTOR
DIVISION OF BANK SUPERVISION
FEDERAL DEPOSIT INSURANCE CORPORATION

Mr. Chairman, I am pleased to have this opportunity to come before the House Subcommittee on Conservation, Credit, and Rural Development to discuss farm bank problems and regulatory responses. Today, I would like to review briefly the prospects for farm banks, describe what the regulatory agencies have accomplished to date, and discuss a number of remaining policy issues on which the Congress and the state legislatures can help. As requested, I will also comment specifically on H.R. 3868, the "Farm Credit Partnership Act," and Titles II and III of H.R. 4267.

Many farm banks are finding it increasingly difficult to withstand the pressures created by the adverse developments in the agricultural sector during the past five years. There are close to 4,000 banks that have 25 percent or more of their loan portfolios in farm loans. This represents about 28 percent of all commercial banks. Most of these banks are located in the Midwest and Great Plains states and are typically small, with total assets equal to only about four percent of all U.S. commercial bank assets. While there were only seven agricultural bank failures in 1982 and seven more in 1983, there were 25 farm bank failures in 1984 and an additional 62 agricultural bank failures this past year. Thirteen farm banks have failed thus far this year.

Current trends suggest that, at least for the next year, farm bank problems and failures are likely to continue at levels at least equal to those experienced during 1985. While profitability has been trending down for small banks in general, it has been falling more rapidly at agricultural banks. Net loan losses at agricultural banks nearly tripled over the past two years. Presently, the FDIC's problem bank list includes 461 farm banks, about 39 percent of the total of all problem commercial banks.

There are, nonetheless, a number of positive signs. The aggregate primary capital ratio for agricultural banks is about 10 percent, roughly equivalent to what is was two years ago, and well above that of other small banks. Moreover, most farm banks are performing well and only about one percent of all farm banks have a primary capital ratio below six percent.

When considering farm issues, one must keep in mind that the basic problem faced is one of the difficult conditions of the agricultural economy and not a banking problem as such. Banks may provide some short-term and limited aid, but only a return to prosperity for the farmer can bring a cure. We must be careful not to create a banking system problem because of difficulties in the agricultural or any other sector of the economy.

While the farm economy is the basic problem, there are obviously a number of spillover effects. The FDIC and the other bank regulatory agencies have taken a number of steps to deal with the specific problems faced by farm bank lenders. Perhaps most importantly, the FDIC recently adopted a capital forbearance policy. Provided certain conditions are met, the policy provides that the FDIC will not take administrative enforcement action to enforce normal capital standards against banks with concentrations in agricultural and energy lending should their primary capital ratio declines to no less than four percent before December 31, 1987. In special circumstances, capital forbearance may be extended to such banks with primary capital ratios as low as three percent. Normally, the FDIC requires a minimum primary capital ratio of 5.5 percent of total assets.

In addition, the FDIC, together with the other bank regulatory agencies, has agreed to a joint statement on regulatory policies towards agricultural lenders. This statement contains four elements. In addition to a commitment to capital forbearance, which we have implemented as described, the statement commits the agencies to not discourage banks from forbearing on farm loans through appropriate debt restructurings since such restructurings may be in the best interest of both the bank and the borrower when there is a reasonable prospect that the borrower will eventually be able to repay the loan.

The statement also commits the agencies, consistent with their view toward forbearance, to continue the practice of not requiring automatic charge-off of loans that have been restructured. Generally accepted accounting principles, as set forth in Financial Accounting Standards Board Statement No. 15 (Accounting by Debtors and Creditors for Troubled Debt Restructurings), allow financial institutions to maintain the value of a restructured credit provided that the total of anticipated future cash receipts under the new modified terms, which are both probable and can reasonably be estimated, at least equal the principal value of the loan. To illustrate: A three-year $1,000, 12 percent loan is renegotiated as an $800 five-year 10 percent loan (total payment is 5 x 80 = $400 + $800 = $1200). No loss is reported and the $200 of payment over the original principal is reported as interest received over five years. This method facilitates restructuring loans by permitting principal payments to be made over an extended period and interest rates reduced. Loans can be repaid without requiring any immediate writeoffs. Income loss is recognized through reduced interest income. For loans that meet FASB standards, the impact on the lending bank is very similar to loss deferral.

In the past this option has not been uniformly recognized by bank regulators. However, we have instructed our examiners to accept the FASB #15 concept in accounting for loans so long as they are comfortable with the prospects for the ultimate collectibility of the restructured loans.

Finally, the joint statement commits the banking agencies to changing the manner in which renegotiated debt is reported. The agencies see no compelling reason for interpreting or reporting renegotiated debt with nonperforming loans. In line with this view, the agencies are in the process of modifying regulatory reporting and disclosure requirements for restructured debt so that such debt, if it is performing in accordance with the new terms, will be designated as loans "Restructured and In Compliance With Modified Terms."

Before deciding on our capital forbearance program, the FDIC considered various approaches, including loan loss deferral programs and the use of net worth certificates as a means of maintaining book capital. However, allowing a bank's capital to fall below minimum requirements without taking enforcement action has a similar effect but is simpler than net worth certificates and loss deferral and does not involve the administrative burden of net worth certificates or the accounting variance of loss deferral. However, as bank capital declines so will loan limits to single borrowers and, at some point, this could pose a problem. The Office of the Comptroller of the Currency is developing means to provide relief for national banks but state chartered banks will have to resort to traditional means of dealing with loan limits, such as loan participations, or seek modification of state laws and regulations.

We believe our policy on capital forbearance, in combination with FASB #15, provides considerable latitude to weakened farm banks that have a good chance of surviving. Such policies can also go far in continuing to provide financing to farm borrowers and limiting disruptions in the farm community.

Despite these efforts, however, it is likely that there will continue to be some failures among farm banks. Much of the disruption to farm communities that results from bank failures could be reduced if a way were found to ensure that a failed bank's customers continue to receive banking services. It is our intention to continue with efforts to reduce these disruptions by modifying our procedures with respect to the handling of bank failures. Whenever possible, the FDIC will attempt to find purchasers of failed banks, limiting the number of deposit payoffs. We will also pursue avenues which may enable us to pass a larger portion of a failed bank's assets on to an acquiring bank. Such efforts can limit many of the secondary effects of bank failures and can be accomplished at modest costs.

We also believe that individual states in the farm sector should take a close look at their branching laws and their laws governing the disposal and valuation of real estate acquired by commercial banks. More liberalized branching laws would enable banks to achieve greater diversification which would help banks avoid future difficulties due to weakness in a particular sector of the economy. More immediately, liberalized branching laws would help limit the disruptions to farm communities caused by bank failures and help maintain banking services by increasing the likelihood that a failure could be handled by merger rather than through a deposit payoff. In many small towns, a branch may be feasible whereas a separately organized and capitalized bank may not be viable. Handling a failure through merger may also serve to reduce the cost to the FDIC's insurance fund.

Liberalizing state laws governing the disposal and valuation of real estate acquired by commercial banks may ease some transition costs by allowing banks to lease land back to farmers, rather than selling it and putting an additional downward pressure on land prices.

We would be remiss if we failed to take this opportunity to again urge the Congress to take steps to help maintain the provision of banking services in small communities. The Garn-St Germain Act of 1982 prohibits acquisitions across state lines of troubled banks before they have failed and of failed banks with assets under $500 million. The FDIC believes that these two constraints should be eased by allowing failing bank acquisitions across state lines and by reducing the size criteria so as to maintain the banking services in farm communities.

Mr. Chairman, you have also asked specifically for our legislative recommendations for H.R. 3868, the "Farm Credit Partnership Act," and Titles II and III of H.R. 4267.

The Farm Credit Partnership Act consists essentially of three elements. First, it would establish an interest rate buydown program whereby the interest rate on certain existing loans to qualified farm borrowers could be reduced by five percentage points for three years. The Federal government would compensate the lender for two of the points, the state government for at least one point but not more than two, and the lender must bear one percentage point. Payments on the loans would be restructured in accordance with the borrower's ability to repay. The bill would also establish a principal reduction program whereby commercial banks could write down up to 30 percent of agricultural loans. Borrowers would not be responsible for the portions of their loans that were written down and the Federal government would guarantee the reduced balance for 90 percent of the amount forgiven for a ten year period during which time the guarantee would decline by ten percent per year. The bank in turn would be authorized to amortize its losses on the loans in equal instalments over ten years. Finally, the Act would direct the Federal bank regulatory agencies to form an interagency task force to assist agricultural banks and their borrowers to work through their present difficulties and facilitate bank lending to agriculture in the future.

Assuming the necessary funds can be made available, the interest rate buydown and principal reduction programs could have a very positive impact on farmers by reducing their cash flow needs and overall debt load. Nonetheless, we have certain reservations with respect to each of the major elements of the bill. With regard to the interest buydown program, it is not at all clear that the program provides sufficient incentives for state and lender participation despite its evident costs and administrative burdens. In addition, there is the question of equity for other hard pressed borrowers in other industries who could make comparable, and quite costly, claims on the public treasury.

With regard to the principal reduction and deferral losses program, we have a similar reservation about the sufficiency of the incentives for lender participation. In most cases, we would doubt that lenders would be willing to sustain a charge off and loss in return for a partial guarantee of the remaining balance on a loan. Moreover, we think it is unwise to compromise accounting standards and the integrity of financial reports by authorizing loan loss deferral over ten years. To an extent, our supervisory efforts, which depend in part on accurate reporting, could be adversely impacted as well.

We believe a statutory mandate for an interagency task force to address agricultural lending problems is unnecessary since the agencies are already cooperating closely to address these very issues as evidenced, for example, by the recent joint policy statement.

Title II of H.R. 4267 would establish a debt adjustment program whereby the Federal government would guarantee up to 90 percent of the principal and accrued interest on new loans to farmers provided the lender permanently cancelled existing indebtedness by at least 10 percent and to the extent necessary to assure that the new loan will show a positive cash flow for at least a five year period. The rate charged on the new loan could not exceed the cost of funds to the lender although the Federal government would repay the lender for the amount cancelled to the extent of one percent, on an annualized basis, for each ten percent of the debt cancelled.

Again, we doubt there is sufficient incentive to lender participation in most cases as the program is structured.

Title III of H.R. 4267 would authorize loss deferral on agricultural loans and other assets of agricultural banks. For the reasons already indicated, we could not support such a proposal.

With regard to both H.R. 3868 and H.R. 4267, we believe that further action on these measures should be held in abeyance pending the results of the recent regulatory initiatives by the banking agencies. As I indicated earlier, the system of farm bank lenders is certainly not in any crisis situation despite the failures that will continue to occur. What is needed is a turnaround in farm markets and programs that assist farmers directly.

Mr. Chairman, I would be pleased to respond to any questions you or the other members of the Subcommittee may have.

TESTIMONY OF

VANCE L. CLARK, ADMINISTRATOR

FARMERS HOME ADMINISTRATION

Before the

SUBCOMMITTEE ON CONSERVATION, CREDIT AND RURAL DEVELOPMENT

HOUSE AGRICULTURE COMMITTEE

April 9, 1986

Mr. Chairman, members of the Committee, I appreciate this opportunity to discuss ways of assuring farm credit at low interest rates to financially troubled farmers throughout the nation.

More specifically, I've been asked to comment on the proposed Farm Credit Partnership Act (H.R. 3868) and the debt adjustment amendments (H.R. 4267, Title II) to the Consolidated Farm and Rural Development Act.

First, Mr. Chairman, I'm encouraged by the attention being given to the concept of using guaranteed loan programs to meet specific farm credit needs. The Farmers Home Administration, as "a lender of last resort," is committed to moving toward an all guaranteed program.

The legislation before us, to a large extent, is recognition that credit from the private sector is available even to hard pressed farmers if they can show a chance of success and if the credit risk can be shared.

Having said that, let me quickly add that, because of recent changes in Farmers Home programs and funding, I do not believe that further legislation in this field is necessary.

In recognition of the fact that in the long run guaranteed lending is less expensive to the government, Congress increased FY 1986 appropriations for FmHA guaranteed farm loans from $1.1 billion in fiscal 1985 to $2 billion this year.

As of Friday, April 4, Farmers Home had guaranteed 4,825 farm loans for a total of $513.7 million so far this fiscal year. That compares with 1,767 guarantees for $220.5 million at this time last year. Last year - fiscal 1985 - was the first year that guaranteed loans played a significant role in Farmers Home Administration's farm lending. Guarantees reached $1 billion for the first time. In 1984 farm loan guarantees amounted to $443 million and the year before that $70 million.

We have great expectations for guaranteed lending this year, especially since the private lending institutions are showing greater interest in the program. Farmers Home has lined up over 2,200 Approved Lenders. These lenders are aware of Farmers Home requirements and have agreed to handle much of the guaranteed loan processing using their own loan documents, not FmHA documents thereby reducing paper work normally required.

In many parts of the country, independent banks and FCS lenders are beginning to recognize the advantages of guaranteed loans for their hard pressed customers. I'd like to publicly express my appreciation to those members of Congress who helped set up information meetings between Farmers and local lenders to discuss the mutual benefits of guaranteed loans. That assistance has been invaluable!

In other areas of the country, there is still a good deal of work to be done to convince local lenders that there are benefits to guaranteed loans. We strongly suspect persistent negative views are based on past isolated adverse experiences. In our early attempts at guarantees, I've heard that we picked too many nits.

The system now has been greatly improved. For instance, recent regulations allow a line of credit to be established through a guaranteed loan; permit the use of guaranteed loans for refinancing purposes; allow multi-note packaging for sale on the secondary markets; and provide for settlement of loss claims prior to complete liquidation. FmHA also has agreed to shorten the turn around time between application by the lender and a loan decision by the agency.

We have been working hard to get the word out on the improved guaranteed loan program. In addition to the kinds of meetings with bankers I mentioned earlier, we have done a number of teleconference and video tapes on the subject. The American Bankers Association was especially helpful in producing and distributing an interview on video tape which answered many of the questions posed by bankers. We will continue to promote the concept of guaranteed farm loans wherever we can. We expect that even reluctant lenders will become more involved as the benefits become more apparent.

The interest buy down program, mandated in the 1985 Farm Bill, went into effect on March 18. The first interest rate reduction agreement took place two weeks ago in Iowa, and another later in Wisconsin. It is too soon to have solid evidence of the eventual success of the program; however, there appears to be a good deal of interest building. This up to two percent buy down program, shared with the lender, is the program that most private lenders were advocating last year when the FmHA debt adjustment program was initiated.

As I have indicated, Mr. Chairman, we expect the Farmers Home guaranteed program to grow, and the interest rate buy down program to be successful. These programs, in addition to our direct lending, should be sufficient to meet the credit needs during fiscal 1986.

For these and other reasons, we recommend against creating a new layer of bureaucracy to accomplish what Farmers Home is already doing. For the most part, the proposed Farm Credit Partnership Act and the debt adjustment amendments are redundant and could in fact impede progress toward greater use of guaranteed funding.

The FmHA interest buy down program is reality; already in operation. There is nothing to prevent states from offering an additional interest rate reduction to lenders if they choose to do so. The Farm Credit Partnership could require an entirely new, but unneeded, structure within the USDA and the states to achieve Federal-state-lender cooperation. Among other problems it would, in my estimation, create an accounting nightmare.

A major concern is the cost of the proposed buy down system. The Federal government would be called upon to contribute $600 million to the states for each of the three years of the program. In addition, the Federal government would pay one half of all state administrative costs. It appears that the total cost would run close to $2 billion over the next three years.

In contrast, the Farm Bill provided $490 million to FmHA over the next three years to accomplish the same goals. Our first year allocation for the program is $114,840,000. We project that those funds could generate as much as $5.7 billion in guaranteed farm loans.

The loan principal reduction features of Title III of H.R. 3868 appear to be more restrictive than current FmHA procedures. One of the major differences is that the guarantee could not be paid out unless the lending institution is completely liquidated. FmHA can presently make a preliminary settlement prior to liquidation. That's an important and attractive feature for participating lenders.

Mr. Chairman, for these and other reasons, we recommend against passage of the proposed legislation. I'll be pleased to answer whatever questions you or the committee may have.

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99TH CONGRESS
1ST SESSION

H. R. 3868

To provide an opportunity for agricultural borrowers to restructure loans from commercial lenders and Farm Credit System institutions in order to maintain the viability of their farming operations and thus preserve the family farm system as the backbone of American agriculture.

IN THE HOUSE OF REPRESENTATIVES

DECEMBER 5, 1985

Mr. PANETTA (for himself, Mr. DE LA GARZA, Mr. JONES of Tennessee, Mr. STANGELAND, Mr. ENGLISH, Mr. PENNY, Mr. EVANS of Iowa, Mr. THOMAS of Georgia, Mr. MORRISON of Washington, Mr. SYNAR, and Mr. STALLINGS) introduced the following bill; which was referred to the Committee on Agriculture

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A BILL

To provide an opportunity for agricultural borrowers to restructure loans from commercial lenders and Farm Credit System institutions in order to maintain the viability of their farming operations and thus preserve the family farm system as the backbone of American agriculture.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

TITLE I—SHORT TITLE

SEC. 101. This Act may be cited as the "Farm Credit Partnership Act".

TITLE II—DEFINITIONS

SEC. 201. For the purposes of this Act, as used in the term:

(a) "Borrower" means any individual, family corporation, or family partnership who or which derives not less than 50 per centum of gross annual income for not less than four out of the past five years from production of raw agricultural products, including livestock or poultry and the products of aquaculture, and who or which, on the date of enactment of this Act, holds from a lender a loan or loans for agricultural purposes which is substandard.

(b) "Lender" means any commerical bank, savings and loan association, credit union, insurance company, or institution (defined in subsection (c)), which includes subsidiaries and affiliates of the above which has agreed to participate in the interest subsidy and loan reduction programs established pursuant to this Act and has been designated in a State plan approved by the Secretary under title II of this Act.

(c) "Institution" means any bank or association of the Farm Credit System established under the Farm Credit Act of 1971, as amended, section 2001 of title 12, United States Code, and the following.

(d) "State" means each of the several States of the United States, the District of Columbia, the Commonwealths of Puerto Rico and the Northern Mariana Islands, the United

States Virgin Islands, Guam, American Samoa and, to the extent the Secretary of Agriculture determiens it to be feasible and appropriate, the Trust Territory of the Pacific Islands.

(e) "State agency" means the official or agency designated by the State to administer the programs established by this Act in that State.

SEC. 202. Assistance to any borrower under this Act shall be limited to an aggregate outstanding amount, including principal and interest, which does not exceed $400,000 in the case of an individual, and $600,000 in the case of a family corporation or family partnership. In order to qualify for assistance a borrower must demonstrate to the satisfaction of the lender:

(a) average gross annual sales in excess of $30,000 for not less than three of the preceding five tax years;

(b) a debt to asset ratio in excess of 40 per centum;

(c) ability, based upon past performance as a capable producer, to repay the debt after restructuring pursuant to this Act where such restructuring is jointly agreed to by borrower and lender.

SEC. 203. (a) Subject to the availability of funds provided pursuant to subsection (e) of this section, the Secretary of

Agriculture (hereinafter referred to as the Secretary) in consultation and cooperation with the Secretary of the Treasury, Controller of the Currency, Chairman of the Federal Reserve Board, Governor of the Farm Credit Administration, Federal Deposit Insuance Corporation, and each State agency, shall establish a cooperative Federal-State-Lender Agricultural Loan Interest Subsidy (AgLIS) Program in which, at the request of a State, borrowers and lenders within the State shall be provided an opportunity to participate. During the year beginning on the date of the United States Department of Agriculture's approval of a State's plan, as defined in this section and ending on a date one year later a borrower may apply to a lender for an interest rate subsidity with respect to any agricultural loan to that borrower from that lender outstanding on October 1, 1985. Upon such application by a borrower who or which qualifies for assistance under this Act and agreement by the lender, the loan shall be restructured within ninety days of date of such application in such a manner that the interest rate of the borrower shall be fixed for a period of three years or the remaining term of the loan, whichever is less, at a rate equal to the rate of the borrower's loan as of December 1, 1985, less up to 5 percentage points. Of the up to 5 percentage point reduction or subsidy, 2 percentage points shall be paid by the Secretary through the State agency to the lender, not less than 1 percentage point nor more than 2 percentage points shall be paid to the lender by the State, and, subject to the provisions of section 301(b) of this Act, 1 percentage point shall be borne by the lender. Any State which requests participation in the program but declines to bear that State's share of the interest subsidy shall nonetheless be required to file and implement a State plan as required by this section, but shall be ineligible for reimbursement of administrative expenses as provided by this section. The term to maturity of any debt for which interest subsidy is provided under this section shall not be less than the term to maturity of the debt outstanding before such subsidy is provided. Payments on such debt shall be restructured in accordance with the borrower's ability to repay. Accrued interest on such outstanding debt prior to restructuring shall not be capitalized but shall be paid by the borrower to the lender prior to any retirement of principal under the loan agreement as restructured pursuant to this Act. Any balance of principal and interest outstanding at the end of three years on any loan restructured under this Act shall be repaid as agreed between borrower and lender at a rate of interest not to exceed the standard rate then charged by the lender on loans with comparable maturities for similar purposes.

(b)(1)(A) From the sums available pursuant to subsection (e) of this section the Secretary shall, subject to the provisions of this subsection and subsection (c), pay to State agencies an aggregate sum not to exceed $600,000,000 for each of the fiscal years 1986, 1987, 1988, and 1989 to finance the Secretary's share of agricultural loan interest subsidies provided to lenders and, in States contributing to the subsidy, 50 per centum of the approved State administrative expenses related to the provision of such assistance.

(B) The payment or payments to each State agency for any year shall be in such amount or amounts as the Secretary may determine and shall not exceed the expenditures by that State during that year for the provision of the Secretary's share of the interest subsidy to participating lenders according to the plan of the State approved under subsection (c) and, in States contributing to the subsidy, 50 per centum of the related approved State administrative expenses.

(2) The Secretary shall, subject to the provisions of subsection (c), pay to each State for the applicable year, at such times and in such manner as the Secretary may determine, the amount estimated by the State pursuant to subsection (c)(1)(A)(iv), reduced or increased to the extent of any prior overpayment or current underpayment which the Secretary determines has been made under this section and with respect to which adjustment has not already been made under this subsection.

(c)(1)(A) In order for borrowers and their lenders to receive benefits under this Act for any year, each State shall have a plan for the year approved by the Secretary under this section. By June 1, 1986, and March 1 of each year hereafter, in which the interest subsidy is available, if the State wishes borrowers and their lenders to receive benefits, it shall submit a plan which—

(i) designates a single agency which shall be responsible for the administration, or supervision of the administration, of the program for the provision of such subsidy;

(ii) assesses the interest subsidy needs of borrowers residing in the State;

(iii) describes the program for the provision of such interest subsidy, including the lenders to whom such subsidy will be paid and any agencies designated to provide such payments, which program must meet such requirements as the Secretary may prescribe;

(iv) estimates the amount of expenditures necessary for the provision of the interest subsidy, and, in States contributing to the interest subsidy, related administrative expenses up to the amount allocated by the Secretary for payment in that State out of the total amount available for payment pursuant to subsection (b)(1)(A);

(v) requires any institution participating in the programs established by this Act to provide to any borrower whose loan is, or becomes, nonperforming between the date of enactment of this Act and thirty days prior to the ending date defined in section 203(a); and

(vi) includes such other information as the Secretary may require.

(B)(i) The Secretary shall approve or disapprove any plan submitted pursuant to subparagraph (A) no later than July 15, 1986, and April 15, in subsequent years, in which it is submitted. The Secretary shall approve any plan which complies with the requirements of subparagraph (A). If a plan is disapproved because it does not comply with any of the requirements of that subparagraph the Secretary shall, except as provided in subparagraph (B)(ii), notify the appropriate State agency that payments will not be made to it under subsection (b) for the year to which the plan applies until the Secretary is satisfied that there is no longer any such failure to comply, and until the Secretary is so satisfied, the Secretary shall make no payments.

(ii) The Secretary may suspend the denial of payments under subparagraph (B)(i) for such period as the Secretary determines appropriate and instead withhold payments of approved State administrative expenses related to provisions of assistance in States contributing to the interest subsidy, in whole or in part, for the year to which the plan applies, until the Secretary is satisfied that there is no longer any failure to comply with the requirements of subparagraph (A), at which time such withheld payments shall be paid.

(2)(A) The State shall provide for an annual audit of expenditures under its program for the provision of the interest subsidy described in subsection (b)(1)(A), within sixty days of the end of each year in which the interest subsidy is provided and shall promptly report to the Secretary the findings of such audit.

(B) Within sixty days of the end of each year in which the interest subsidy is available the State shall provide the Secretary with a statement as to whether the payments received under subsection (b) for that year exceeded the expenditures by it during that year for which payment is authorized under this section, and if so, by how much, and such other information as the Secretary may require.

(C)(i) If the Secretary finds that there is a substantial failure by the State to comply with any of the requirements of subparagraphs (A) and (B), or to comply with the requirements of subsection (c)(1)(A) in the administration of a plan approved under subsection (c)(1)(B), the Secretary shall, except as provided in subparagraph (C)(ii), notify the State agency in the State that further payments will not be made to it under subsection (b) until the Secretary is satisfied that there will no longer be any such failure to comply, and until the Secretary is so satisfied, the Secretary shall make no further payments.

(ii) The Secretary may suspend the termination of payments under subparagraph (C)(i) for such period as the Secretary determines appropriate, and instead withhold payments of approved State administrative expenses related to provision of assistance in States contributing to the interest subsidy, in whole or in part, until the Secretary is satisfied that there will no longer be any failure to comply with the requirements of subparagraphs (A) and (B) and subsection (c)(1)(A), at which time such withheld payments shall be paid.

(iii) Upon finding under subparagraph (C)(i) of a substantial failure to comply with any of the requirements of subparagraphs (A) and (B) and subsection (c)(1)(A), the Secretary may, in addition to or in lieu of any action taken under subparagraphs (C)(i) and (C)(ii), refer the matter to the Attorney General with a request that injunctive relief be sought to require compliance by the State and upon suit by the Attorney General in an appropriate district court of the United States and a showing that noncompliance has occurred, appropriate injunctive relief shall issue.

(d) The Secretary shall provide for review and, in the discretion of the Secretary, audit of the program for which payments are made under this section, and may, as the Secretary deems practicable, provide to the States technical assistance with respect to such a program.

(e) There is authorized to be appropriated such sums as may be necessary to carry out the provisions of this section. In order to make assistance available expeditiously and in a consistent and uninterrupted manner the Secretary is authorized and directed to utilize the funds, personnel and facilities of the United States Department of Agriculture, including those of the Commodity Credit Corporation (CCC), and of any other Federal or State agency whose assistance is required to establish and carry out the AgLIS Program. However, the Congress shall, not later than the next ensuing appropriation act provide full reimbursement of any sums advanced pursuant to this section and is authorized to appropriate such sums for the AgLIS Program as may be necessary based on the Secretary's estimate of anticipated Federal costs.

(f) The State agency shall have the authority to monitor lender's compliance with section 203(a). Any lender found in violation of that section shall not be eligible to receive further payments under this Act.

SEC. 204. (a) An institution may take action as the result of a borrower defaulting on an outstanding loan made by such institution to any borrower only if—

(1) a thirty-day notice of availability of assistance under this Act has been provided as required by section 203(c)(1)(A)(v) of this Act, and

(2) any such borrower who has applied for assistance has been determined not to qualify for assistance under this section.

SEC. 205. (a) Provisions of this title shall become effective in a particular State upon adoption of that State's State plan.

TITLE III—AGRICULTURAL LOAN PRINCIPAL REDUCTION

SEC. 301. (a) GENERAL RULES.—For the purposes of this title, the term a "qualified institution" means an institution the deposits of which are insured under the Federal Deposit Insurance Act (12 U.S.C. 1823) or insured or guaranteed under State law.

(b) Any lender participating in the programs provided under this Act may during the period beginning thirty days after the date of enactment write down the outstanding principal balance on the loan or loans of such borrower by such amount, as will permit such borrower to qualify for assistance. The balance of the principal remaining after such write-down and the accrued interest attributable thereto shall be rescheduled for payment. The borrower shall not be liable for repayment of that portion of the outstanding principal balance written down pursuant to this section nor for the accrued interest attributable thereto.

(c) Any loan which has had the outstanding principal balance written down pursuant to this section, is also eligible for the interest subsidy once that program is in place.

(d) If the write-down of principal needed to enable the borrower to qualify for assistance under this Act equals or exceeds 15 per centum of the principal balance outstanding, the qualified institution shall not be liable for any portion of the cost of the interest subsidy provided under title II of this Act. In such case the interest subsidy shall total only such amount as is paid by the Secretary and the State, if such State is contributing to the interest subsidy.

SEC. 302. (a) FARMERS HOME ADMINISTRATION GUARANTEES.—Effective only for the period beginning on the date of enactment of this Act and ending September 30, 1988, the Consolidated Farm and Rural Development Act (7 U.S.C. 1921 et seq.) is further amended by adding at the end thereof the following new section:

"SEC. 351. (a) The Secretary shall establish and carry out in accordance with this section a guaranteed loan program pursuant to the Agricultural Loan Cancellation Program established by this title.

"(b) For purposes of this section—

"(1) An Agricultural Loan Cancellation Program shall not—

"(A) be limited to cancellation of not more than 30 per centum of the first $500,000 of agricultural loans made to an individual farmer ($750,000 in the case of a partnership or corporation engaged in farming); and

"(B) be limited to borrowers with gross sales in excess of $30,000 debt to asset ratios in excess of 40 per centum prior to cancellation, and debt to asset ratios of less than 100 per centum after cancellation;

"(2) The term 'qualified institution' means an institution the deposits of which are insured under the Federal Deposit Insurance Act (12 U.S.C. 1823) or insured or guaranteed under State law; and

"(3) The term 'restructured loan' means the agricultural loan that results after loan cancellations made under paragraph (1).

"(c) Upon the request of a qualified institution, the Secretary shall issue a guarantee to such qualified institution in an amount equal to 90 per centum of the amount of principal forgiven pursuant to the Agricultural Loan Cancellation Program of this section: *Provided,* That—

"(1) the guarantee period is ten years;

"(2) the guarantee declines by ten per annum;

"(3) the restructured loan will not be eligible for other guarantees under this title;

"(4) the guaranteed portion of the restructured loan can only be exercised if the qualified institution is totally liquidated by the lender's lead financial regulator;

"(5) restructured loans pursuant to this section shall not be transferable; and

"(6) the loss incurred by a qualified institution as a result of a loan cancellation under this section shall be recognized in equal annual installments over a period of not to exceed ten years, except that if such institution forecloses on any loan a portion of which was forgiven under this section, the entire remaining balance of the forgiven portion of that loan shall be charged off in the year of the foreclosure.

"(d) Guarantees under subsection (c) shall be issued by the Secretary upon certification by the qualified institution that such institution—

"(1) has net worth equal to or greater than 4 per centum of its assets; and

"(2) has implemented an Agricultural Loan Cancellation Program in accordance with subsection (b).

"(e) The amendments made by this section shall apply with respect to loan principal cancellations which are put into effect during the period as defined in section 301(b).".

TITLE IV—MISCELLANEOUS PROVISIONS

SEC. 401. Recognizing the severe economic problems confronted by many agricultural banks and the regulatory responsibilities of the Federal Deposit Insurance Corporation (FDIC), the Comptroller of the Currency (CCC), and the Federal Reserve System, these bank regulatory agencies shall develop within thirty days of enactment of this Act an Inter-Agency Agricultural Task Force to assist commercial agricultural banks and their borrowers to work through the present economic problems and to facilitate commercial bank lending to agriculture in the future. Specifically, the Inter-Agency Task Force should:

(1) review existing regulations and policies to facilitate agricultural lending;

(2) work with field office personnel to avoid conflicts and inconsistencies between the agencies;

(3) consider meaningful alternatives to assist commercial banks in providing agricultural financing by regulatory or statutory changes including accounting changes, interest rate buydowns, or other similar methods for assisting banks. Require that no later than March 1, 1986, and semiannually thereafter, each

Agency shall report of its findings and recommendations to the Committee on Agriculture of the House of Representatives, the Committee on Agriculture, Nutrition, and Forestry of the Senate, Committee on Banking, Finance and Urban Affairs of the House of Representatives, and the Committee on Banking, Housing, and Urban Affairs of the Senate.

SEC. 402. The provisions of the constitution or law of any State imposing any penalty, limitation, or moratorium relating to fixed rate mortgages shall not apply to any extension of credit in the form of a fixed rate mortgage made under this Act.

SEC. 403. Whoever embezzles, misapplies, steals, or obtains by fraud, false statements, or forgery, any funds, assets, or property provided or financed under this section shall be fined not more than $10,000 or imprisoned for not more than five years, or both.

SEC. 404. There are authorized to be issued such regulations as may be necessary to carry out the provisions of this Act.

SEC. 405. There are hereby authorized to be appropriated such sums as may be required to carry out the provisions of this Act.

Farm Credit Administration

1501 Farm Credit Drive
McLean, Virginia 22102-5090
(703) 883-4000

FARM CREDIT ADMINISTRATION

February 12, 1986

Honorable E (Kika) de la Garza
Chairman, Committee on Agriculture
House of Representatives
Washington, DC 20515

Dear Mr. Chairman:

Pursuant to your letter of December 19, 1985, this is a report on H.R. 3868, the Farm Credit Partnership Act.

Title I sets forth the short title of the Act.

Title II targets financial assistance to qualified lenders and borrowers through reductions in interest rates to family farmers within States that have adopted plans approved by the Secretary of Agriculture pursuant to the requirements of the Act. Assistance is provided through interest rate reductions of up to 5 percent: 2 percent paid to lenders through designated State agencies out of funds received from the Secretary; 1 to 2 percent paid to the lender by the State; and 1 percent borne by the lender.

Title III allows qualified commercial lenders to receive the State and Federal interest rate subsidy without bearing a 1-percent reduction in principal on a qualified loan if the lender has written down 15 percent or more of the principal balance. Such a write down shall qualify the lender to participate in an Agricultural Loan Cancellation Program in which 90 percent of the amount of principal forgiven is guaranteed by the Federal Government for a 10-year period, declining by 10 percent per annum, and payable only if the qualified institution is totally liquidated by the lender's lead financial regulator.

Losses taken pursuant to Title III would be recognized in equal installments over a period not to exceed 10 years, unless the loan on which the write down and guarantee was taken is foreclosed, in which case the entire remaining balance of the forgiven portion of the loan shall be charged off in the year of the foreclosure.

Title IV contains miscellaneous provisions establishing an Inter-Agency Task Force, comprised of the Federal Deposit Insurance Corporation, Comptroller of the Currency, and the Federal Reserve, to review regulations, consider meaningful alternatives to assist commercial banks, and report semiannually to the House and Senate agriculture and banking committees; exempting extensions of fixed-rate mortgages under the Act from State penalty, limitation, or moratorium; and establishing appropriate penalties for criminal actions.

COMMENTS

The institutions of the Farm Credit System (System) would only be eligible to participate in the Agricultural Loan Interest Subsidy (AgLIS) program established under Title II. Section 201 (b) defines "lender" as encompassing commercial lenders and System institutions, while Section 201 (c) defines "institution" as any bank or association of the System.

System institutions are the only lenders under the bill subject to the requirements of Section 203 (c)(1)(A)(v) to provide any borrower whose loan is, or becomes, nonperforming at specified times "prompt written notice, which is acknowledged by the borrower within 30 days of receipt, which fully and fairly describes the assistance available under this Act and the deadlines for application."

The Farm Credit Administration (FCA) recommends that if such notice provisions are to be included for the benefit of borrowers with nonperforming loans, then all lenders as defined under Section 201 (b) should be subject to the requirement.

Title III excludes System institutions from participation in the Agricultural Loan Principal Reduction Program by limiting the definition in Section 301 (a) of a "qualified institution" to those with deposits insured under the Federal Deposit Insurance Act (12 U.S.C. 1823) or insured or guaranteed under State law.

FCA generally opposes proposals to artificially defer the recording of loss on loans. While H.R. 3868 provides a guarantee that offsets the written off loan with a substantial asset, the underlying economic condition of the financial institution is not improved by the action.

Title IV, establishing an Inter-Agency Task Force, does not include the FCA. FCA recommends that it be included on the Inter-Agency Task Force in recognition of its comparable role as a Federal financial regulatory agency to that of the other designated participants.

The reference in Section 203 to "Governor of the Farm Credit Administration" should be changed to "Chairman of the Farm Credit Administration" to reflect the provisions of Public Law 99-205.

H.R. 3868 could have a beneficial effect on the safety and soundness of institutions of the System through the provision of Federal and State interest rate subsidies directly to System institutions on behalf of qualified borrowers. Consideration would have to be given by System institutions on a case-by-case basis to determine whether restructuring loans pursuant to the AgLIS program would be in the best interest of borrowers, stockholders in System institutions, and investors in System securities.

The FCA recognizes that the costs associated with H.R. 3868 will contribute to the Federal deficit and therefore encourages industry self-help efforts and State initiatives to ease the burden of the transition presently occurring in the agricultural sector.

ESTIMATE OF THE COST OF ENACTMENT

Section 203 (b)(1)(A) provides that the Secretary shall pay to State agencies an aggregate sum not to exceed $600 million for each of the fiscal years 1986, 1987, 1988, and 1989 to finance the Secretary's share of interest subsidies and, in States contributing to the subsidy, 50 percent of the approved States' administrative expenses related to the provision of such assistance.

Section 203 (e) authorizes to be appropriated such sums as may be necessary to carry out the provisions of the AgLIS program.

No limitation or expected level of funding is indicated in Title III for the Agricultural Loan Principal Reduction Program. Section 405 in Title IV, however, would authorize to be appropriated such sums as may be necessary to carry out the provisions of this Act.

Based upon the criteria for qualifying for the Agricultural Loan Cancellation Program in Section 351 (b), the FCA estimates that approximately $3 billion of commercial bank debt is potentially eligible for a guarantee. This represents about 6 percent of the total outstanding agricultural debt held by commercial lenders and about 14 percent of all commercial lender debt to agricultural borrowers who are leveraged 40 percent or greater debt to assets and who are experiencing a negative cash-flow. These calculations are based upon survey data collected by the U.S. Department of Agriculture.

Sincerely,

Donald E Wilkinson

Donald E. Wilkinson
Acting Chairman

I

99TH CONGRESS
2D SESSION

H. R. 4267

To amend the Agricultural Act of 1949 to provide increased income to producers of wheat and feed grains for the 1986 through 1990 crops of such commodities, to amend the Consolidated Farm and Rural Development Act to provide by law for a debt adjustment program and to require the interest rate for buy-down loans to be not greater than the cost of money to the lending institution, and for other purposes.

IN THE HOUSE OF REPRESENTATIVES

FEBRUARY 27, 1986

Mr. BEDELL (for himself, Mr. DASCHLE, Mr. VOLKMER, Mr. ENGLISH, Mr. PENNY, Mr. GLICKMAN, Mr. EVANS of Illinois, Mr. DORGAN of North Dakota, Mr. SYNAR, Mr. MCCURDY, Mr. WILLIAMS, Mr. SIKORSKI, Mr. WATKINS, Mr. JONES of Oklahoma, Mr. KASTENMEIER, and Mr. ALEXANDER) introduced the following bill; which was referred to the Committee on Agriculture

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A BILL

To amend the Agricultural Act of 1949 to provide increased income to producers of wheat and feed grains for the 1986 through 1990 crops of such commodities, to amend the Consolidated Farm and Rural Development Act to provide by law for a debt adjustment program and to require the interest rate for buy-down loans to be not greater than the cost of money to the lending institution, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

TITLE I—WHEAT AND FEED GRAINS

SECTION 101. PRODUCTION ACREAGES, MARKETING CERTIFICATES, AND MINIMUM LOAN RATES FOR THE 1986 THROUGH 1990 CROPS OF WHEAT AND FEED GRAINS.

Effective only for the 1986 through 1990 crops, the Agricultural Act of 1949 (7 U.S.C. 1461 et seq.) is amended by adding at the end thereof a new title VI as follows:

"TITLE VI—PRODUCTION ACREAGES, MARKETING CERTIFICATES, AND MINIMUM LOAN RATES FOR THE 1986 THROUGH 1990 CROPS OF WHEAT AND FEED GRAINS

"FINDINGS AND POLICY

"SEC. 601. (a) Congress finds that—

"(1) wheat and feed grains are essential agricultural commodities for the Nation, are produced throughout the United States by hundreds of thousands of farmers, and along with their products flow in substantial amounts through instrumentalities of interstate and foreign commerce from producers to consumers;

"(2) abnormally excessive and abnormally deficient supplies of wheat and feed grains on the countrywide market acutely and directly affect, burden, and obstruct interstate and foreign commerce; and

"(3) interstate and foreign commerce in wheat and feed grains, and their products, should be protected from burdensome surpluses and disruptive shortages, a supply of the commodities should be maintained to meet domestic consumption needs and export demand, and soil and water resources of the Nation should not be squandered in the production of surplus burdensome supplies of the commodities.

"(b) It hereby is declared to be the policy of Congress that it is in the interest of the general welfare to assist in the marketing of wheat and feed grains for domestic consumption and export; to regulate interstate and foreign commerce in the commodities to the extent necessary to provide an orderly, adequate, and balanced flow of the commodities in interstate and foreign commerce; and to provide loans and other means to maintain farm income for producers of the commodities, reduce excess production, and enable consumers to obtain an adequate and steady supply of such commodities at fair prices.

"CONSUMER SAFEGUARDS

"SEC. 602. The powers conferred under this title shall not be used to discourage the production of supplies of food and animal feed sufficient to meet normal domestic and export needs, as determined by the Secretary. In carrying out the purposes of this title, the Secretary shall give due regard to the maintenance of a continuous and stable supply of agricultural commodities from domestic production adequate to meet consumer demand at prices fair both to producers and consumers.

"NATIONAL MARKETING CERTIFICATE PROGRAM—WHEAT

"SEC. 603. (a) Notwithstanding any other provision of this Act, in the case of the 1986 through 1990 crops of wheat, the Secretary shall make available to producers on each farm loans and purchases for such crop of wheat for an amount of wheat produced on the farm equal to the individual farm program acreage for the crop, as determined under section 107D (as limited under subsection (b)), times the farm's program yield for the crop of wheat, as determined by the Secretary. Loans and purchases shall be made available during the marketing year for any such crop of wheat at such level as the Secretary determines will maintain the competitive relationship of wheat to other grains in domestic and export markets after taking into consideration the cost of producing wheat, supply and demand conditions, and world prices for wheat, except that the level of wheat loans and purchases for the 1986 through 1990 marketing years may not be established at less than $5.00 per bushel of wheat.

"(b) Notwithstanding the provisions of section 107D, in the case of the 1986 through 1990 crops of wheat, the individual farm program acreages for such crop may not be established at less than 65 per centum of each farm's wheat crop acreage base for the crop.

"(c)(1)(A) The Secretary shall make available to producers on each farm marketing certificates for the 1986 through 1990 crops of wheat for which a national marketing certificate program is in effect. The amount of such marketing certificates made available to the producers on a farm for a crop shall equal an amount of wheat determined by multiplying the individual farm program acreage for the crop, as determined under section 107D (as limited under subsection (b)), by the farm's program yield for the crop of wheat, as determined by the Secretary. In no event may a farm's program yield for a crop of wheat be less than the farm's program yield for the 1985 crop of wheat.

"(B) The Secretary may make available to importers marketing certificates for wheat or wheat products imported during the marketing year for the 1986 through 1990 crops of wheat for which a national marketing certificate program is in effect. The quantities of such imported wheat or wheat products shall not exceed the amount that may be imported under restrictions resulting from the imposition of measures under section 22 of the Agricultural Adjustment Act of 1933, reenacted by the Agricultural Marketing Agreement Act of 1937.

"(2)(A) A marketing certificate applicable to a crop of wheat issued to a producer shall authorize such producer to market, barter, or donate, without restriction, an amount of wheat equal to the amount of such marketing certificate. Wheat may not be marketed, bartered, or donated domestically by a producer without a marketing certificate, except that wheat not accompanied by a marketing certificate may be used for feed, human consumption, or other purposes on the farm of the producer, or may be sold or otherwise transferred by the producer for export.

"(B) A marketing certificate applicable to a quantity of wheat or wheat products issued to an importer shall authorize such importer to market, barter, or donate, without restriction, an amount of wheat or wheat products equal to the amount of such marketing certificate. Wheat or wheat products may not be marketed, bartered, or donated domestically by an importer without a marketing certificate.

"(3) Wheat accompanied by a marketing certificate that is sold or otherwise transferred for export shall be eligible for an export incentive payment on such wheat, as provided in section 611.

"(4) Wheat accompanied by a marketing certificate that is marketed, bartered, or donated domestically and purchased or otherwise acquired by a domestic user of such wheat may be eligible for an incentive payment, as determined by the Secretary, to assure that such wheat and the products thereof remain competitive in the domestic market for such wheat and wheat products.

"(5) If for any crop, wheat that the producer harvests exceeds the amount of the commodity that may be marketed, bartered, or donated by the producer under a marketing certificate, the excess may be used for feed, human consumption, or other purposes on the farm of the producer or sold or otherwise transferred for export. In addition, such excess may be carried over by the producer from one marketing year to the succeeding marketing year and marketed under a certificate in the succeeding marketing year to the extent that (A) the total amount of such wheat available for marketing under a certificate from the farm in the marketing year from which such commodity is carried over does not exceed the amount of the marketing certificates made available to the producers on the farm for that crop, and (B) the total amount of wheat available for marketing under a certificate in the succeeding marketing year (that is, the sum of the amount of such wheat carried over and the amount of wheat produced on the farm eligible for marketing certificates in the succeeding year) does not exceed the amount of marketing certificates made available to the producers on the farm for the succeeding marketing year.

"(6) Marketing certificates made available to a producer or an importer of wheat or wheat products shall not be transferable, except to the extent that such certificates accompany wheat or wheat products that are marketed, bartered, or donated under paragraph (2), and any such transfer that does not accompany wheat or wheat products shall render such certificates null and void.

"(7) Wheat harvested in a calendar year in which marketing certificates are made available to producers for the marketing year beginning therein may not be marketed by a producer under a certificate prior to the date on which such marketing year begins.

"(8) No person may purchase or otherwise acquire an amount of wheat in excess of the amount of wheat that may be marketed, bartered, or donated under marketing certificates issued under this title and held or readily available, except wheat that must be exported may be acquired as provided under paragraph (2).

"(9) If marketing certificates for wheat are not made available to producers for any crop, all previous marketing certificates applicable to wheat shall be terminated, effective as of the first day of the marketing year for such crop of wheat.

"(10) Except as otherwise provided in this title, the disaster payment, program yield, program acreage, acreage reduction, paid diversion, and related provisions of section 107D shall apply to producers of wheat for which a national marketing certificate program is in effect under this title.

"PENALTIES WITH RESPECT TO WHEAT

"SEC. 604. (a)(1) Notwithstanding any other provision of this Act, except as provided in subsection (b), if a producer fails to comply with any term or condition of a wheat program conducted under this title, the producer shall be ineligible for any loan, purchase, or payment under this Act for the crop of wheat involved.

"(2) Except as provided in subsection (c), during the marketing year for any crop of wheat for which marketing certificates are made available to producers, if any person markets, barters, or donates wheat other than for export without marketing certificates issued under section 603 or markets, barters, or donates an amount of wheat for domestic use in excess of the amount of wheat the person is permitted to market, barter, or donate under such certificates, the Secretary shall—

"(A) assess a civil penalty against such person in an amount equal to three times the current minimum loan rate for the wheat so marketed, bartered, or donated, or

"(B) with respect to a producer, decrease the number of acres of the farm's individual farm program acreage for wheat such producer may devote to production for the succeeding crop of wheat by a number of acres that, if planted, would result in the production of a quantity sufficient to satisfy the penalty referred to in subparagraph (A).

"(3) If a person, knowingly purchases or otherwise acquires an amount of wheat for any purpose other than export in excess of the amount of wheat that may be marketed, bartered, or donated by such person under marketing certificates issued under this title and held or readily available to such person, the Secretary shall assess a civil penalty against such person in an amount equal to three times the current minimum loan rate for the wheat so purchased or acquired.

"(b) If a producer fails to comply fully with the terms and conditions of a wheat program conducted under this title and the Secretary believes the failure should not preclude the making of loans, purchases, or payments under this Act to the producer, the Secretary may make loans, purchases, or payments in such amounts as the Secretary determines to be equitable in relation to the severity of the program violation.

"(c) If the Secretary otherwise determines that the penalties provided for in subsection (a) are not warranted by the severity of the program violation, the Secretary may reduce or waive such penalties.

"(d) Penalties collected under this section shall be deposited into the account of the Commodity Credit Corporation.

"(e) The prohibitions and penalties for marketing, bartering, donating, purchasing, or otherwise acquiring wheat set out in this section or section 603 shall apply to wheat in unprocessed or processed form, and to products of wheat, prior to the conversion of such wheat or wheat products into end-use food or other products or intermediate-use products in which the wheat or wheat product loses its separate identity.

"NATIONAL MARKETING CERTIFICATE PROGRAM—FEED GRAINS

"SEC. 605. (a)(1) Notwithstanding any other provision of this Act, in the case of the 1986 through 1990 crops of feed grains, the Secretary shall make available to producers on each farm loans and purchases for such crop of feed grains for an amount of feed grains produced on the farm equal to the individual farm program acreage for the crop, as determined under section 105C (as limited under subsection (b)), times the farm program yield for the crop, as determined by the Secretary.

"(2) Loans and purchases shall be made available during the marketing year for any such crop of corn at such level as the Secretary determines will maintain the competitive relationship of feed grains to other grains in domestic and export markets after taking into consideration the cost of producing feed grains, supply and demand conditions, and world prices for feed grains, except that the level of corn loans and purchases for the 1986 through 1990 marketing years may not be established at less than $3.50 per bushel of corn.

"(3) Loans and purchases shall be made available for a crop of grain sorghums, barley, oats, or rye, respectively, at such level as the Secretary determines is fair and reasonable in relation to the level most loans and purchases are made available for corn under this subsection, taking into consideration the feeding value of such commodity in relation to corn and other factors specified in section 401(b) of this Act.

"(b) Notwithstanding the provisions of section 107D, in the case of the 1986 through 1990 crops of feed grains, the individual farm program acreages for such crop may not be established at less than 80 per centum of each farm's feed grains crop acreage base for the crop.

"(c)(1)(A) The Secretary shall make available to producers on each farm marketing certificates for any of the 1986 through 1990 crops of feed grains for which a national marketing certificate program is in effect. The amount of such marketing certificates made available to the producers on a farm for a crop shall equal an amount of feed grains determined by multiplying the individual farm program acreage for the crop, as determined under section 105C (as limited under subsection (b)), by the farm's program yield for the crop, as determined by the Secretary. In no event may a farm's program yield for a crop of feed grains be less than the farm's program yield for the 1985 crop of feed grains.

"(B) The Secretary may make available to importers marketing certificates for feed grains or feed grain products imported during the marketing year for any of the 1986 through 1990 crops of feed grains for which a national marketing certificate program is in effect. The quantities of such imported feed grains or feed grain products shall not exceed the amount that may be imported under restrictions resulting from the imposition of measures under section 22 of the Agricultural Adjustment Act of 1933, reenacted by the Agricultural Marketing Agreement Act of 1937.

"(2)(A) A marketing certificate applicable to a crop of feed grains issued to a producer shall authorize such producer to market, barter, or donate, without restriction, an amount of feed grains equal to the amount of such marketing certificate. Feed grains may not be marketed, bartered, or donated domestically by a producer without a marketing certificate, except that feed grains not accompanied by a marketing certificate may be used for feed, human consumption, or other purposes on the farm of the producer, or may be sold or otherwise transferred by the producer for export.

"(B) A marketing certificate applicable to a quantity of feed grains or feed grain products issued to an importer shall authorize such importer to market, barter, or donate, without restriction, an amount of feed grains or feed grain products equal to the amount of such marketing certificate. Feed grains or feed grain products may not be marketed, bartered, or donated domestically by an importer without a marketing certificate.

"(3) Feed grains accompanied by a marketing certificate that are sold or otherwise transferred for export shall be eligible for an export incentive on such feed grains, as provided in section 611.

"(4) Feed grains accompanied by a marketing certificate that are marketed, bartered, or donated domestically and purchased or otherwise acquired by a domestic user of such feed grains may be eligible for an incentive payment, as determined by the Secretary, to ensure that such feed grains and the products thereof remain competitive in the domestic market for such feed grains and feed grain products.

"(5) If for any crop, feed grains that the producer harvests exceed the amount of the commodity that may be marketed, bartered, or donated by the producer under a marketing certificate, the excess may be used for feed, human consumption, or other purposes on the farm of the producer, or sold or otherwise transferred for export. In addition, such excess may be carried over by the producer from one marketing year to the succeeding marketing year and marketed under a certificate in the succeeding marketing year to the extent that (A) the total amount of such feed grains available for marketing under a certificate from the farm in the marketing year from which such commodity is carried over does not exceed the amount of the marketing certificates made available to the producers on the farm for that crop, and (B) the total amount of feed grains available for marketing under a certificate in the succeeding marketing year (that is, the sum of the amount of such feed grains carried over and the amount of feed grains produced on the farm eligible for marketing certificates in the succeeding year) does not exceed the amount of marketing certificates made available to the producers on the farm for the succeeding marketing year.

"(6) Marketing certificates made available to a producer or an importer of feed grains or feed grain products shall not be transferable, except to the extent that such certificates accompany feed grains or feed grain products that are marketed, bartered, or donated under paragraph (2), and any such transfer that does not accompany feed grains or feed grain products shall render such certificates null and void.

"(7) Feed grains harvested in a calendar year in which marketing certificates are made available to producers for the marketing year beginning therein may not be marketed by a producer under a certificate prior to the date on which such marketing year begins.

"(8) No person may purchase or otherwise acquire an amount of feed grains in excess of the amount of feed grains that may be marketed, bartered, or donated under marketing certificates issued under this title and held or readily available, except that feed grains that must be exported may be acquired as provided under paragraph (2).

"(9) If marketing certificates for feed grains are not made available to producers for any crop, all previous marketing certificates applicable to feed grains shall be terminated, effective as of the first day of the marketing year for such crop of feed grains.

"(10) Except as otherwise provided in this title, the disaster payment, program yield, program acreage, acreage reduction, paid diversion, and related provisions of section 105C shall apply to feed grains and producers of feed grains for which a national marketing certificate program is in effect under this title.

"PENALTIES WITH RESPECT TO FEED GRAINS

"SEC. 606. (a)(1) Notwithstanding any other provision of this Act, except as provided in subsection (b), if a producer fails to comply with any term or condition of a feed grain program conducted under this title, the producer shall be ineligible for any loan, purchase, or payment under this Act for the crop of feed grains involved.

"(2) Except as provided in subsection (c), during the marketing year for any crop of feed grains for which a marketing certificate is made available to producers if any person markets, barters, or donates feed grains other than for export without a marketing certificate issued under section 605 or markets, barters, or donates feed grains other than for domestic use in excess of the amount of the commodity the person is permitted to market, barter, or donate under such certificates, the Secretary shall—

"(A) assess a civil penalty against such person in an amount equal to three times the current minimum loan rate for the feed grains so marketed, bartered, or donated, or

"(B) with respect to a producer, decrease the number of acres of the farm's individual farm program acreage for feed grains such producer may devote to production for the succeeding crop of feed grains by a number of acres that, if planted, would result in the production of a quantity sufficient to satisfy the penalty referred to in subparagraph (A).

"(3) if a person knowingly purchases or otherwise acquires an amount of feed grains for any purpose other than export in excess of the amount of feed grains that may be marketed, bartered, or donated by such person under marketing certificates issued under this title and held or readily available to such person, the Secretary shall assess a civil penalty against such person in an amount equal to three times the current minimum loan rate for the feed grains so purchased or acquired.

"(b) If a producer fails to comply fully with the terms and conditions of a feed grain program conducted under this title and the Secretary believes the failure should not preclude the making of loans, purchases, or payments under this Act to the producer, the Secretary may make loans, purchases, or payments in such amounts as the Secretary determines to be equitable in relation to the severity of the program violation.

"(c) If the Secretary otherwise determines that the penalties provided for in subsection (a) are not warranted by the severity of the program violation, the Secretary may reduce or waive such penalties.

"(d) Penalties collected under this section shall be deposited into the account of the Commodity Credit Corporation.

"(e) The prohibition and penalties for marketing, bartering, donating, purchasing, or otherwise acquiring feed grains set out in this section and section 605 shall apply to feed grains in unprocessed or processed form, and to products of feed grains, prior to the conversion of such feed grains or feed grain products into end-use food or other products or intermediate-use products in which the feed grains or feed grain product loses its separate identity.

“PROGRAM BASES

“Sec. 607. Notwithstanding any other provision of law, for the 1986 through 1990 crops of wheat or feed grains for which a national marketing certificate program is in effect, no producer of such crop, may adjust the producer's crop acreage base for the crop and the producer's base for such crop shall be as determined by the Secretary.

“FEES OR QUANTITATIVE LIMITATIONS

“Sec. 608. In carrying out the provisions of this title, the Secretary shall advise the President, as necessary, under section 22 of the Agricultural Adjustment Act of 1933, reenacted by the Agricultural Marketing Agreements Act of 1937, of the need to impose fees or quantitative limitations on any article or articles that may be imported, to ensure that such article or articles that may be imported do not render ineffective the loan and purchase programs authorized under this title.

“TRANSITION REGULATIONS

“Sec. 609. (a) The Secretary may issue such regulations as the Secretary determines necessary to carry out this title, including procedures to ensure the equitable treatment of producers with wheat or feed grains under loan at such time that the marketing certificate program authorized under this title takes effect.

“(b) The procedures prescribed under subsection (a) shall offer such producers the opportunity to extend the period of such loans, forfeit the grain securing such loans, or continue to store such grain in a manner that will reduce to the Government the cost of otherwise acquiring and storing such grain. In no case shall such procedures require producers to redeem grain held under section 110.

"USE OF THE COMMODITY CREDIT CORPORATION

"SEC. 610. The Secretary shall carry out programs provided for under this title through the Commodity Credit Corporation.

"EXPORT INCENTIVES

"SEC. 611. The Secretary of Agriculture shall provide agricultural commodities or cash, or both to the extent necessary to reduce to world price levels, as determined by the Secretary, the cost to exporters (including the cost of acquisition, handling, and an amount that reflects a fair return to such exporters) of grain purchased for export by such exporters and accompanied by a marketing certificate as provided under this title.".

SEC. 102. TECHNICAL AMENDMENTS.

(a) 1938 ACT.—Effective for each of the 1986 through 1990 crops of wheat and feed grains, the Agricultural Adjustment Act of 1938 is amended by—

(1) in section 301(b)(6)—

(A) inserting "(excluding wheat and corn with respect to any crop in which a program is in effect under title VI of the Agricultural Act of 1949", and

(B) adding at the end thereof the following:

"(D) 'Market', in the case of wheat and feed grains of any crop for which a program is in effect under title VI of the Agricultural Act of 1949, means to dispose of by voluntary or involuntary sale or exchange.";

(2) inserting "or title VI of the Agricultural Act of 1949" after "this Act" both places that phrase appears in section 372(d);

(3) in section 373—

(A) striking out "corn" both places that word appears in the first sentence of subsection (a) and inserting in lieu thereof "feed grains";

(B) inserting "and title VI of the Agricultural Act of 1949" after "this title" in the second sentence of subsection (a); and

(C) striking out "corn, wheat" in subsection (b) and inserting in lieu thereof "feed grains", and inserting "and title VI of the Agricultural Act of 1949" after "this title";

(4) in section 375(a), inserting "other feed grains," after "corn", and inserting "or title VI of the Agricultural Act of 1949" after "this title"; and

(5) inserting "and title VI of the Agricultural Act of 1949" after "this title" both places it appears in section 376.

(b) 1949 ACT.—Effective for each of the 1986 through 1990 crops of wheat and feed grains, section 401(c) of the Agricultural Act of 1949 (7 U.S.C. 1421(c)) is amended by inserting after the first sentence the following: "Compliance by the producer with requirements under title VI, if programs under title VI are in effect for a crop, shall be required as a condition of price support.".

TITLE II—DEBT ADJUSTMENT

SEC. 201. DEBT ADJUSTMENT PROGRAM.

The Consolidated Farm and Rural Development Act (7 U.S.C. 1921 et seq.) is amended by adding at the end thereof the following:

"SEC. 353. (a) The Secretary shall provide a debt adjustment program (hereinafter in this section referred to as the 'program') utilizing—

"(1) new operating loans; and

"(2) new farm ownership loans

guaranteed, except as otherwise provided in this section, in accordance with the provisions of this Act other than this section.

"(b) A guarantee under the program shall be for the equivalent of 90 per centum of principal and accrued interest of the new loan.

"(c) Guarantees may be made under the program only with respect to new loans to operators of not larger than family farms who—

"(1) do not have the ability to repay their existing loans under current terms and conditions; or

"(2) do not have adequate security for their existing loans without debt adjustment.

"(d)(1) A lender whose loan is guaranteed under the program shall permanently cancel existing indebtedness, to that lender, of the operator to whom the new loan is made, to the extent necessary to assure that such new loan will show a positive cash flow for at least a 5-year period.

"(2) For the purposes of this section, a loan shows a positive cash flow if, for the period such cash flow is to be examined, anticipated cash inflows are at least 100 per centum of anticipated cash outflows. Such anticipated cash inflows and outflows shall include all anticipated cash inflows and outflows from farm and nonfarm activities, but shall exclude capital expenditures.

"(e)(1) A cancellation under this subsection shall be—

"(A) an immediate cancellation of existing indebtedness (including principal or accrued interest, or both such principal and accrued interest);

"(B) a reduction in the interest rate; or

"(C) a combination of such an immediate cancellation and such a reduction;

so that the outstanding amount of the original debt (including both principal and accrued interest) is directly or in effect reduced by not less than 10 per centum.

"(2) Whatever method is used under paragraph (1) to effect the cancellation, the Secretary shall by rule assure that there results the same level of Federal risk exposure, during each year of that exposure, under the guarantee of the new loan as there would under an immediate cancellation of the equivalent percentage.

"(f) The interest rate on a loan guaranteed under the program shall not exceed the rate of the cost of funds to the lender at the time such contract is made. The Secretary shall make a payment to the lender of an amount equal, on an annualized basis, to 1 percentage point of the reduction for each ten per centum of the debt written off.

"(g) The Secretary may prescribe additional terms and conditions to be met by the lender and the borrower with respect to loans guaranteed under the program.

"(h) The Secretary may issue regulations to carry out this section.".

TITLE III—AGRICULTURAL LOAN LOSSES

SEC. 301. ACCOUNTING AND RELATED EVALUATIONS

Section 13 of the Federal Deposit Insurance Act (12 U.S.C. 1823) is amended by adding at the end thereof the following:

"(j)(1) The appropriate Federal banking agency shall permit an agricultural bank to take the actions referred to in paragraph (2) if it finds that there is no evidence that fraud or criminal abuse on the part of the bank led to the losses referred to in paragraph (2).

"(2)(A) Any loss on any qualified agricultural loan that an agricultural bank would otherwise be required to show on its annual financial statement for any year between December 31, 1984, and January 1, 1990, may be amortized on its financial statements over a period of not to exceed 10 years, as specified in regulations issued by the appropriate Federal banking agency.

"(B) An agricultural bank may reappraise the value of any real estate or other property, real or personal, that it acquired coincident to the making of a qualified agricultural loan and that it owned on January 1, 1985, and any such additional property that it acquires prior to January 1, 1990. Any loss that such bank would otherwise be required to show on its annual financial statements as the result of such reappraisal may be amortized on its financial statements over a period of not to exceed 10 years, as specified in regulations issued by the appropriate Federal banking agency.

"(3) The appropriate Federal banking agency may issue regulations implementing this subsection with respect to banks that it supervises.

"(4) As used in this subsection—

"(A) the term 'agricultural bank' means a bank which is significantly involved in agricultural lending, as determined by the appropriate Federal banking agency, and the deposits of which are insured by the Federal Deposit Insurance Corporation; and

"(B) the term 'qualified agricultural loan' means a loan made to finance the production of agricultural products or livestock in the United States, a loan secured by farmland or farm machinery, or such other category of loans as the appropriate Federal banking agency may deem eligible.".

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